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# Audit of the Deposit Beverage Container Program

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawaii

Report No. 05-09  
November 2005



**THE AUDITOR**  
STATE OF HAWAII

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## The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



### THE AUDITOR

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# OVERVIEW

## *Audit of the Deposit Beverage Container Program*

Report No. 05-09, November 2005

### Summary

Our audit of the State's "bottle bill" program found that despite more than a two-year lead time to prepare for consumer redemptions of beverage container deposits, the Department of Health was not ready to properly and efficiently return consumers' deposits. Staff were hired only from October 2004 and were unable to resolve potential problems before January 1, 2005—when consumers could start redeeming their accumulated bottles. Despite collecting over \$39 million as of June 30, 2005, the department lacks an auditable financial accounting system and cannot ensure that all revenues and payments are properly accounted for. We conducted this audit pursuant to Section 342G-107, Hawai'i Revised Statutes (HRS), which requires us to conduct management and financial audits for FY2004-05 and FY2005-06.

We redeemed containers at 33 redemption centers on O'ahu, Hawai'i, Maui, and Kaua'i and experienced first-hand the problems and frustrations faced by consumers. The process was confusing and our observations confirm many of the public complaints—centers opening late, closing early, or not opening at all, often because they run out of money or storage capacity; inconvenient locations and hours of operation; long wait times; inconsistency; poor customer service; and general confusion about the redemption process. Many view the program as an attempt to impose another state tax by forcing consumers to pay the deposit but making it difficult to obtain the refund. Furthermore, prior to the enactment of the bottle bill, recyclers paid consumers the scrap value for their containers. Currently, only a few redemption centers pay scrap value in addition to the refund, because there is no requirement to do so.

Although the department has been working with redemption center operators to resolve the problems, the efforts have produced negligible results. The department hesitated to enforce penalties in part because of the limited number of companies certified to operate the centers.

The over \$39 million in payments from distributors, importers, and manufacturers as of June 30, 2005 consists of both the five cent deposit refund per container and one-half cent container fee, which increased to one cent on October 1, 2004. Distributors, importers, and manufacturers are required to submit a department form with their payment, but the department does not verify that either the data on these forms or the payments received are correct. Although we attempted to audit the records of selected distributors, we were unable to obtain enough documentation to attest to the accuracy of the numbers submitted and the amounts of the resulting payments. Consequently, the department cannot verify that distributors are paying what they owe.



From January to June 2005, the first six months of the program, the department has paid over \$10 million to redemption centers—approximately \$8 million for reimbursements and \$2 million for handling fees. These payments are being made based on numbers submitted by the redemption centers and are not verified by the department because it has not developed procedures to do so. Potentially the department could be paying for nonexistent and unlabeled containers.

We engaged the certified public accounting firm of Shigemura and Sakamaki CPAs, Inc., to conduct the financial audit of the program. However, the contractor determined that the department had not established a proper accounting system and could not prepare any financial statements for the program. Therefore, our consultant was unable to complete the financial audit of the program.

Although individual staff initially assigned to implement the program labored under adverse conditions, they were further hampered by the administration's attempts to repeal the law and its emphasis on recovering deposits instead of a sufficient environmental, recycling message.

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## Recommendations and Response

Our recommendations included the governor's assistance in the Department of Health's implementation of the program according to Section 342G, Part VIII, HRS. We recommended that the department verify data reported by redemption and recycling centers and evaluate whether handling fees are sufficient to sustain acceptable levels of service. Regarding financial controls, we included recommendations that the Department of Health provide fiscal guidance to and oversight of the program, properly review and maintain accounting records, and have proper cut-off dates for transactions.

The Department of Health strongly disagreed with some of the conclusions and claims that it can, and has, accounted for every penny in the program—reflecting a clear misunderstanding of the seriousness of the issue regarding its financial controls. Ironically, despite the department's objections to several of our conclusions, it responded that it has drafted many of the procedures that we recommended, is seeking to hire more accounting staff, and will address the specific criticisms in the audit.

The governor's senior policy advisor opted to provide a response to our audit, and alleged that there were a number of inaccuracies and oversights in the draft. The advisor asked that we spend additional time talking to the department. We disagree. Our staff spent a great deal of time meeting with department staff, often multiple times, and we are confident of our understanding of the program and the events that occurred.

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawai`i

Conducted by

The Auditor  
State of Hawai`i  
and  
Shigemura and  
Sakamaki, CPAs,  
Inc.

Submitted by

**THE AUDITOR**  
STATE OF HAWAI`I

Report No. 05-09  
November 2005

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## Foreword

We conducted this audit of the Department of Health's Deposit Beverage Container Program pursuant to Section 342G-107, Hawai'i Revised Statutes, which requires that the Office of the Auditor conduct a management and financial audit of the program for fiscal years 2004-05 and 2005-06, and for each fiscal year thereafter ending in an even-numbered year. We engaged the certified public accounting firm of Shigemura and Sakamaki CPAs, Inc., as our consultant to conduct the financial audit of the program.

We wish to express our appreciation for the cooperation and assistance extended to us by the Department of Health and other offices and individuals whom we contacted during the course of our audit.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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### Background

Hawai‘i’s Legislature has long recognized the importance of managing and protecting the state’s environment through recycling efforts. Glass container importers have been paying a glass advance disposal fee of 1.5 cents per container for several years—since September 1, 1994. The revenue from these fees was deposited into an account in the State Department of Health’s Environmental Management Special Fund and financed county glass recovery programs. To further protect the environment, increase recycling, and reduce litter, the 2002 Legislature passed Act 176, or the “bottle bill,” to establish the Deposit Beverage Container Program.

In the bill’s preamble, the Legislature emphasized that recycling is an important element of an integrated solid waste management system, which can protect and preserve environmental resources and reduce economic costs to residents and businesses. The Legislature also noted a need to expand participation in recycling programs and minimize costs to those participating and to government. The purpose of Act 176 is to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter. The nickel-redemption program initiated by the bill aims to recover 80 percent of the estimated 800 million bottles and cans used annually in Hawai‘i. With the passage of Act 176, Hawai‘i became one of 11 states to have some form of beverage container recycling program. The ten other states are California, Connecticut, Delaware, Iowa, Maine, Massachusetts, Michigan, New York, Oregon, and Vermont.

Act 176, codified as Chapter 342G, Part VIII, of the Hawai‘i Revised Statutes (HRS), requires that the Auditor conduct a management and financial audit of the Deposit Beverage Container Program. More specifically, Section 342G-107, HRS, requires such an audit for FY2004-05 and FY2005-06, and for each fiscal year thereafter ending in an even-numbered year. For FY2004-05, we conducted the management audit and contracted with a CPA firm to undertake the financial audit.

Appendix A contains a glossary for this report.

### ***Inception of the Deposit Beverage Container Program***

The State Department of Health’s Office of Solid Waste Management administers the Deposit Beverage Container Program and the program’s special fund. On October 1, 2002, distributors began paying into the special fund a deposit beverage container fee of .5 cent (one-half cent) for each plastic or metal container they manufactured or imported into

Hawai'i. On October 1, 2004, this container fee increased to one cent per container and glass beverage containers, as well as plastic and metal containers, were included in the program. As a result, the glass advance disposal fee paid by glass container importers now applies only to those containers not included in the Deposit Beverage Container Program.

In addition to the one-cent container fee, distributors were supposed to start paying a five-cent per container refundable deposit to the department on January 1, 2005. However, during the 2004 Regular Session, the Legislature passed Act 241. This act allowed distributors to begin paying the refundable deposit as early as November 1, 2004 provided their containers were marked with the five-cent refund value. Act 241 also allowed dealers to charge customers the refund value for marked containers on November 1, 2004, although customers could not redeem these containers until January 1, 2005. Consequently, customers were forced to pay the five cent refund value and to store the containers for two months before they could recover their money. This was the beginning of the public's frustration with the redemption process.

### ***Redemption process***

An individual or business that wants to operate a redemption center must receive both a solid waste permit and a redemption center certification from the Department of Health. In addition to the conditions listed in the permit and certification, redemption centers must comply with the statutory requirements in Section 342G-114, HRS, which are: 1) accepting all types of empty deposit beverage containers for which a deposit has been paid; 2) verifying that all containers to be redeemed bear a valid Hawai'i refund value; 3) paying the redeemer for the full refund value in either cash or a redeemable voucher for all deposit beverage containers, except as provided in Section 342G-116 (lists conditions for refusal); 4) ensuring each deposit beverage container is recycled through a contractual agreement with an out-of-state recycler or an in-state recycling facility permitted by the department (not applicable if redemption center is operated by a recycler permitted by the department); and 5) forwarding the documentation necessary to support claims for payment as stated in Section 342G-119 (redemption center reporting requirements).

The counties are eligible for money from the special fund to help them establish redemption centers. The department signed memoranda of agreement with Hawai'i and Maui counties for \$250,000 per county in FY2004-05 and with Kaua'i County for \$100,000 from October 1, 2004 to June 30, 2005. According to the recycling coordinator of the City and County of Honolulu, the city declined to apply for funding because it felt the goals of the memorandum were to oversee the redemption center operations for the Department of Health. The city did not want to take over this state responsibility. The city suggested that the limited amount

of money go to the neighbor island counties where the department did not have a staff presence. For FY2005-06, the department has replaced the counties' memoranda of agreement with contracts that can be extended for up to three years. The contract amounts for the counties are \$750,000 for Hawai'i, \$750,000 for Maui, and \$327,310 for Kaua'i.

As of August 2005, the Department of Health had a total of 57 certified redemption centers on O'ahu and the neighbor islands. This total does not include the mobile redemption centers. Exhibit 1.1 provides a breakdown of sites on each island.

### **Exhibit 1.1 Certified Redemption Centers**

<b>Island</b>	<b>Centers Open</b>	
O'ahu	27	Staffed sites and reverse vending machine sites; plus 17 mobile redemption centers
Maui	11	Staffed and reverse vending machine sites
Hawai'i	11	Staffed sites
Kaua'i	6	Staffed sites
Lāna'i	1	Staffed site
Moloka'i	1	Staffed site
<b>TOTAL</b>	<b>57</b>	

Source: Department of Health

Consumers began paying a one-cent container fee on October 1, 2004. This non-refundable container fee is used to cover the costs of supporting redemption operations, collection, handling, transportation, and administration costs. From November 1, 2004, consumers also paid a five-cent refundable deposit for each labeled beverage container purchased. Beginning January 1, 2005 certified redemption centers began refunding the five-cent per container deposit to the public for redeemed containers.

The Department of Health outlined the following steps for those interested in recycling at a redemption center: 1) sort deposit containers from non-deposit containers; 2) sort by material type (aluminum, bimetal, glass, and plastic); 3) empty containers of liquid or other foreign material, although rinsing containers is not necessary; and 4) remove caps from the containers. Initially containers could not be flattened; however, as of July 7, 2005 flattened containers are accepted at redemption centers but not by reverse vending machines.

Consumers should also know that redemption centers have the option of weighing quantities of 50 or more containers rather than counting them. When containers are weighed, the redemption center must use the state-provided segregated rates to calculate the number of redeemed containers per pound. The segregated rates are based on an average number of containers per pound, so the consumer may receive more or less than five cents per container. The number of containers per pound by material type is required to be posted at the redemption center. Exhibit 1.2 contains the current segregated rates. It should be noted that non-deposit beverage containers can also be recycled, but without refund.

**Exhibit 1.2**  
**Hawai'i Deposit Beverage Container Law Segregated Rates**

Effective March 23, 2005

<b>Deposit Container Material Type</b>	<b>Number of Containers per Pound</b>
Aluminum	30.0
Bi-metal	8.0
Glass	2.4
Plastic (PET & HDPE)	16.6

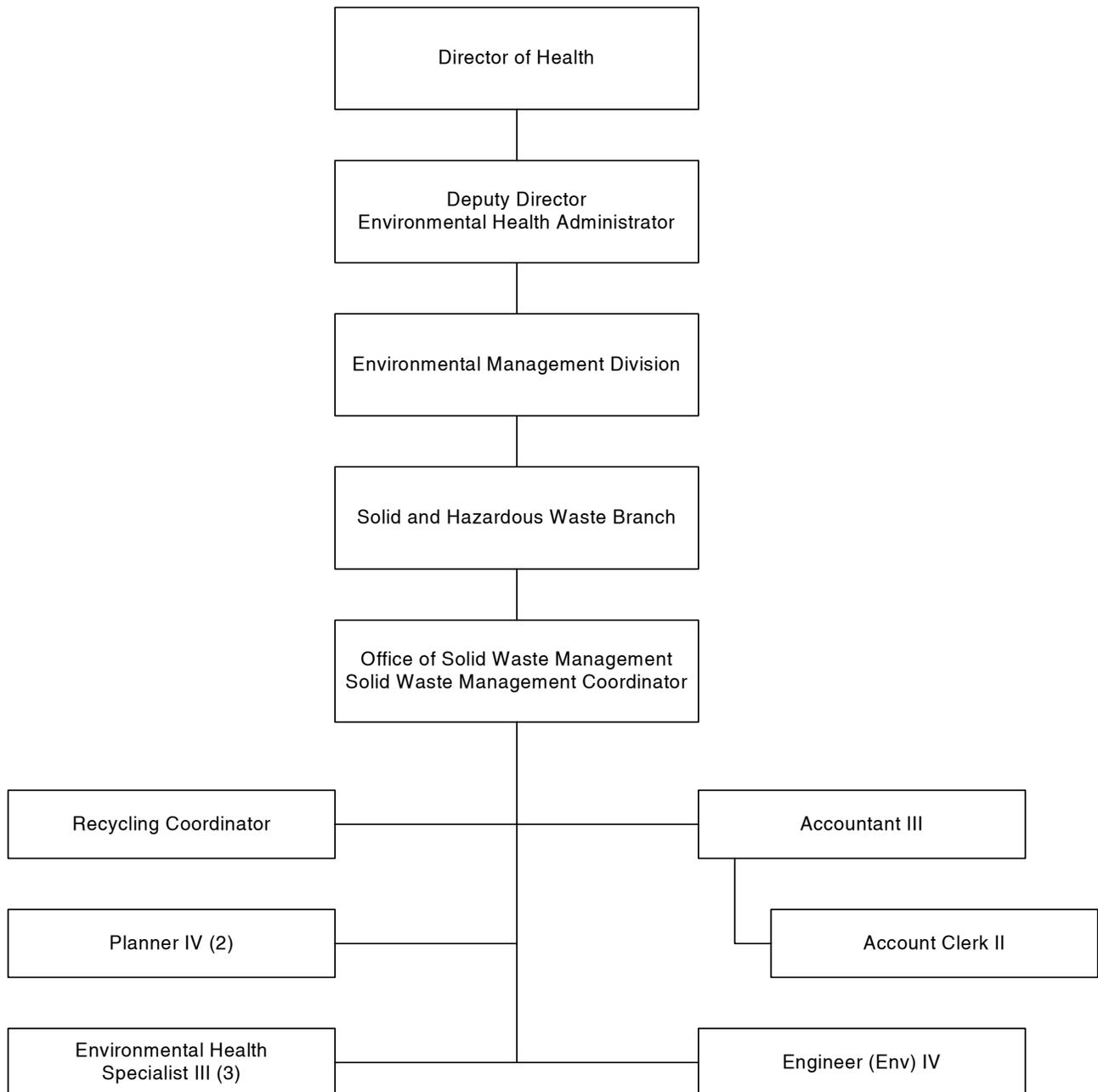
***Organization and staffing for the program***

The Department of Health's Environmental Management Division, Solid and Hazardous Waste Branch, Office of Solid Waste Management is responsible for the implementation and administration of the Deposit Beverage Container Program—a program with estimated revenue of \$48 million a year. Exhibit 1.3 shows the organization chart of the program.

Six temporary civil service positions are authorized for the program and funded by the program's special fund. The six positions consist of an engineer IV, three environmental health specialist IIIs, an accountant III, and an account clerk II. All six positions report to the solid waste management coordinator of the Office of Solid Waste Management. The duties of the coordinator position are currently being shared by the director of the department's Office of Environmental Quality Control and the chief of the Environmental Management Division. The position has not been filled since 1999, except through the temporary assignment of two different employees from April 1999 to April 2002 and from September 2003 to May 2004.

The primary function of the engineer IV, according to the position description, is to review and approve certified redemption centers, coordinate compliance inspections of those facilities, and oversee the investigations of unpermitted activities. Additionally, the position

**Exhibit 1.3**  
**Department of Health**  
**Organization of the Deposit Beverage Container Program**



Note: This is not the official organization chart of the Deposit Beverage Container Program, but reflects the actual program organization as reported by the Department of Health. The numbers in parentheses indicate the total number of positions.

operates as part of the certification and enforcement team providing technical assistance to the regulated community and responding to requests for public information.

The environmental health specialist III positions assist the head of the Deposit Beverage Container Program by investigating compliance and complaints associated with the program and providing general analysis and support for promotion of waste reduction measures. Inspection activities are comprised of: 1) planning and organizing inspection of solid waste disposal facilities; 2) conducting a compliance program for monitoring solid waste processing and disposal facilities; 3) reporting to the Solid Waste Management Coordinator any violations of a facility's permit conditions; 4) assisting in evaluation of data submitted by permittees of solid waste facilities; 5) investigating complaints of improper management and operation of solid waste facilities; 6) making reports regarding any needed modifications to permits; and 7) providing information and technical assistance regarding solid waste facilities.

The accountant III position provides fiscal support to the Deposit Beverage Container Deposit Special Fund and the Environmental Special Fund, analyzes fiscal data, prepares daily and special reports, and maintains and develops expenditure records for all program funding sources.

The account clerk II provides fiscal support by carrying out such duties as: 1) establishing and maintaining ledgers for the disbursement of state, federal, and special funds; 2) maintaining current records of planned, budgeted, and expended funds; 3) processing invoices and preparing vouchers for approval to authorize payments; and 4) maintaining vendor payment files and records.

### ***Deposit Beverage Container Deposit Special Fund***

Section 342G-104, HRS, established the Deposit Beverage Container Deposit Special Fund in the state treasury. The distributors' five-cent refundable deposit and one-cent container fee for each eligible beverage container sold in the state produces revenue for the fund. Interest accrued on the fund balance provides additional revenue.

Fund expenditures include the five-cent deposit paid as a reimbursement to certified redemption centers for each container redeemed and a handling fee per container of two cents on O'ahu and three cents on the neighbor islands. The Department of Health may also use the money in the special fund to: 1) fund administrative, audit, and compliance activities associated with collection and payment of the deposits and handling fees of the deposit beverage container program; 2) conduct recycling education and demonstration projects; 3) promote recyclable market development activities; 4) support the handling and transportation

of the deposit beverage containers to end-markets; 5) hire personnel to oversee the implementation of the deposit beverage container program, including permitting and enforcement activities; and 6) fund associated office expenses.

The department reported collecting over \$39 million from October 2002 when distributors began paying the .5 cent container fee through June 30, 2005. This total includes both deposit redemption fees and container fees collected from distributors, importers, and manufacturers. The department also noted that from January 2005 to June 30, 2005, more than 212 million beverage containers were turned in for recycling in Hawai'i. Exhibit 1.4 provides a basic depiction of the redemption process, starting with the distributor.

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## Prior Audits

Since the Deposit Beverage Container Program was recently established, this is our first audit of the program.

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## Objectives

1. Assess the efficiency and effectiveness of the Department of Health's management of the Deposit Beverage Container Program.
2. Conduct a financial audit of the program, including information on the amount of unredeemed refund value.
3. Make recommendations as appropriate.

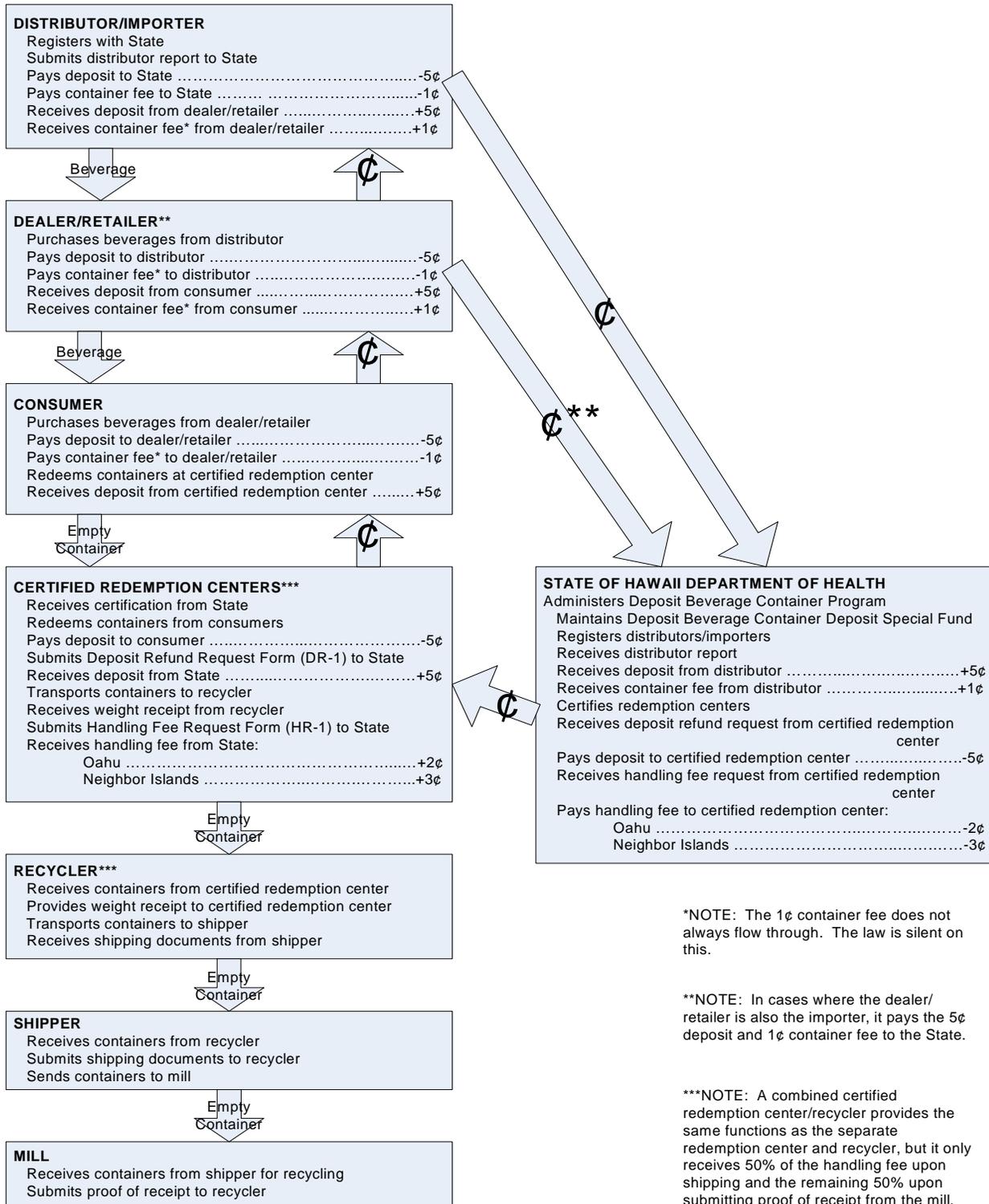
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## Scope and Methodology

Our audit reviewed the management and fiscal practices of the Department of Health's Deposit Beverage Container Program. Our statewide review of the program focused on FY2004-05, but also included previous fiscal years with regard to the special fund and the department's efforts to implement the program.

We conducted interviews, reviewed documents, and visited redemption centers on O'ahu, Hawai'i, Kaua'i, and Maui. We also selected and reviewed relevant documents on the management of the program to determine whether prescribed law and/or policy were met, whether the system is efficiently and effectively managed, and whether there is documentary evidence of on-going performance monitoring. We reviewed the program for compliance with applicable statutes, rules, and policies and assessed management controls relevant to the objectives of the audit.

### Exhibit 1.4 Basic Redemption Process



\*NOTE: The 1¢ container fee does not always flow through. The law is silent on this.

\*\*NOTE: In cases where the dealer/retailer is also the importer, it pays the 5¢ deposit and 1¢ container fee to the State.

\*\*\*NOTE: A combined certified redemption center/recycler provides the same functions as the separate redemption center and recycler, but it only receives 50% of the handling fee upon shipping and the remaining 50% upon submitting proof of receipt from the mill.

Source: Department of Health

We contracted with Shigemura and Sakamaki, CPAs, Inc. to conduct the financial portion of the audit, which included the following objectives:

1. Assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the program, to recommend improvements to such systems, procedures, and reports, and to report on the fair presentation of the revenues, expenditures, and fund balance of the program;
2. Ascertain whether expenditures or deductions and other disbursements have been made and all revenues or additions and other receipts have been collected and accounted for in accordance with applicable laws, rules and regulations, and policies and procedures of the State of Hawai‘i; and
3. Make recommendations as appropriate.

Our audit work was conducted from May 2005 through October 2005 according to generally accepted government auditing standards.

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# Chapter 2

## The Department of Health Has Not Operated the Deposit Beverage Container Program To Succeed

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The Department of Health’s passive oversight of the Deposit Beverage Container Program and its financial accounting system have hampered attainment of successful operations and placed the program’s viability in question. Further, the greater environmental message and benefits of recycling have been overlooked in the redemption process. Immediate steps must be taken to improve the program’s operational and financial management and public education to ensure its future.

In the course of our bottle bill audit, we identified issues that have negatively impacted and slowed the program’s success. These issues—a flawed program start-up caused by numerous delays, including the department’s time spent in assisting the administration with its efforts to repeal the “bottle bill” and the department’s oversight practices—affect the success of a recycling effort that is integral to protecting and preserving Hawai‘i’s environmental resources and reducing economic costs to residents and businesses. Accordingly, a discussion of these points and their impacts are included in our report.

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### Summary of Findings

1. Numerous delays in the Department of Health negatively impacted the program’s planning and implementation.
2. The department has failed to establish a financial accounting system to ensure that transactions are properly recorded and reported and that assets are safeguarded.

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### Numerous Delays in the Department of Health Negatively Impacted Program Planning and Implementation

Despite a lead time of more than two years, the Department of Health failed to adequately plan for the January 1, 2005 start date of the 800 million container, \$48 million Deposit Beverage Container Program. Instead, the department, under direction from the administration, spent its time seeking repeal of the law and did not hire its first program staff member until October 2004, only three months before the redemption centers began operating.

As a result, the department did not complete the basic preparation necessary for the program to succeed. The department failed to use its ample lead time to submit a timely budget request, hire staff, establish an

infrastructure, and develop and test policies and procedures prior to implementation. What should have been accomplished over the two and a half years prior to January 2005 has instead been hastily cobbled together in a few months and still remains incomplete.

***The department failed to submit a timely budget request for program funding***

The “bottle bill” became law on July 1, 2002 and required deposit beverage container distributors to begin paying a half-cent fee per container to the Department of Health starting October 1, 2002. Two years later, this container fee increased to one-cent per container. On October 1, 2004 retailers could begin charging the one-cent container fee. On November 1, 2004, they could start charging a refundable five cents per container deposit although containers could not be redeemed until January 1, 2005.

Revenue began accumulating in the Deposit Beverage Container Deposit Special Fund in October 2002, but the Department of Health failed to initiate a request to the 2003 Legislature for authority to spend the funds. As a result, although the special fund had grown to more than \$2 million by the end of the 2003 legislative session, the department was unable to access money from the fund to hire staff to plan and implement the program. The department finally sought and received a budget appropriation from the Legislature in 2004. However, the department had lost valuable time in preparing for the program’s start date when consumers could start redeeming empty beverage containers.

***Late hiring of staff limited program planning and implementation efforts***

The Deposit Beverage Container Program was designed to be administered by a solid waste management coordinator. The position has not been permanently filled since April 1999, resulting in other health department employees at times temporarily assuming the coordinator’s duties while also fulfilling the responsibilities of their positions. The coordinator position was vacant during the critical time when program planning, hiring, and infrastructure development should have taken place. Despite the fact that the program still does not have a full-time coordinator, the department has never advertised the position.

Further, failing to initiate a request to the 2003 Legislature, the department did not have authority to spend funds and hire program staff until 2004. Hence, it relied on the help of existing Solid and Hazardous Waste Branch staff members to perform several functions, including developing administrative rules and a marketing plan and creating and maintaining reporting and collection procedures—functions they continued for over two years, in addition to performing their regular jobs. Prior to the hiring of a program accountant, well-intentioned but inadequately trained branch managers and staff set up a system to record and track payments from distributors for the half-cent container fee.

These staff members also set up the accounting software and created a system that works for reporting purposes, but the system does not conform to accounting standards and does not have basic procedures and controls.

The department did not initiate a request to fill staff positions for the program until August 16, 2004, less than five months before the start date of the redemption program. The request was approved by the director of finance “with reservations” on September 22, 2004 and by the governor on October 4, 2004. The first program staff member, an environmental health specialist III, was hired in October 2004. Others followed, including an accountant III and account clerk II in November 2004; an environmental health specialist III in December 2004; another environmental health specialist III in March 2005; and the last employee, an engineer IV, in June 2005.

Position descriptions of the six program employees, which contain their job responsibilities and duties, are not tailored to the Deposit Beverage Container Program. Instead, the department staff used existing branch position descriptions in an attempt to shorten the approval process. The current job descriptions do not clearly reflect the responsibilities of the employees as related to the program, indicating a lack of emphasis on the program. These inadequate job descriptions add to staff confusion and leave open the possibility that staff members may be assigned to help with other programs’ duties.

Since being hired, program staff members have engaged themselves in crisis management and remain in the “program development” phase. When consumers began redeeming containers on January 1, 2005, program staff became swamped with phone calls and public complaints. This necessitated daily meetings among department managers and program staff to keep abreast of changes and consumer complaints. Even as late as August 2005, program staff continued to draft policy and procedure manuals and checklists for redemption center and retail inspections.

The program staff is working hard to make the program succeed; unfortunately, their late hiring has resulted in a perpetual state of trying to catch up. Although they recognize the importance of conducting inspections of redemption centers and retailers, the environmental health specialists, who are responsible for inspection and enforcement, are unable to conduct a sufficient number of inspections. This occurs in part because they have been assigned work unrelated to their positions and are unable to do their jobs. As a result, the public continues to encounter problems with the redemption process.

### **Administration attempts to repeal the bottle bill delayed implementation**

In 2003, the governor vetoed House Bill No. 1456, a bill that would have allowed quicker payments to redemption centers, rather than find ways to support implementation of this high-profile law. In her veto message, the governor clearly stated her opposition to the bill, even noting that a new “bottle” division for containers was not needed in the Department of Health. Although the administration recognized the Legislature’s noble intentions, the administration felt the law was flawed and found government involvement unnecessary. The governor has openly opposed the law and supported bills to repeal it in both the 2003 and 2004 legislative sessions.

These repeal efforts created uncertainty, confusion, and stress among the staff regarding the law, the role of the department, and the governor’s direction for the department. While the department supported the administration’s bill to repeal the law, the department simultaneously attempted to implement it. Although the director of health has stated that the administration’s stance had minimal impact on the program’s failings, our interviews with staff reveal the contrary. Although the staff put forth their best efforts, they were always uncertain about whether the program would be repealed—and they still believe it may be terminated.

### **The administration made it difficult to fill staff positions**

Permanent positions are beneficial to creating stability for an organization. Section 17 of Act 176, Session Laws of Hawaii 2002, states that all program positions are to remain temporary unless explicitly authorized by the Legislature. Although the department submitted a request to establish permanent positions for the program, the administration decided the positions should be temporary. In early 2003, the branch chief attempted to establish the six temporary program positions, which required the submission of a reorganization plan and delayed the hiring of program staff.

Subsequent to the department’s submittal of the plan, the director of finance begrudgingly approved the hiring of the six program staff “with reservations.” A memo explaining her reservations stated three reasons: 1) the positions requested would be difficult to recruit and fill; 2) with no prior workload data, the six positions may be excessive; and 3) other implementing alternatives, such as enabling the counties to directly operate and integrate the program with their existing waste management and recycling activities, would have allowed the State to focus its responsibility on the financial aspect of the program (monitoring receipts and disbursements).

Administration support for the bottle bill early on would have enabled the department to devote the level of planning, preparation, and problem resolution necessary for a successful program. As it was, the first indication of administration support for department staff efforts came in May 2005, when the administration stated that the beverage container program is law, is not going to change, and must be implemented and supported.

***The public is ill-served  
by poorly operated  
redemption centers***

The department has made it extremely difficult for consumers to participate in the redemption process. Prior to the program's start, consumers were forced to store containers for two months before they could redeem them. Since the start of the redemption program, people have had to locate a center that is open when they are not working, load the bags into their cars, and drive to the nearest center, hoping that it has not run out of storage space or money or closed early for the day. Adding to the hardship, people must stand in line, often for long periods of time in the hot sun and try to decipher the process at that particular center because all centers are not operated in the same manner. People often encounter rude attendants and irate people who are also waiting in line to redeem containers. They feel cheated when the only way they can get their refunds is to have their containers weighed. While reverse vending machines simplify the process, a substantial amount of time is required to feed the containers into the machines.

People have aired their complaints in many ways—sending letters to newspaper editors, calling the Office of the Ombudsman and the Department of Health, among others. A deputy director of the department believes that each letter to the editor represents about 200 people who may share the same sentiments. The department recorded over 200 complaints received during the first six months of 2005.

The bulk of the complaints involve redemption centers opening late, closing early, or not opening at all. Other criticisms by the public include inconvenient locations and hours of operation, long wait times, inconsistency, poor customer service, and general confusion about the redemption process. Complaints also regard retailers not properly labeling and charging for deposit beverage containers. While the department acknowledges that the redemption process has had problems, since the initial publicity campaign the department has all but ignored public complaints by not addressing them and by not continuously informing the public of changes to the redemption process. Poor management practices by redemption center operators give the State a bad name, yet the department has not adequately attempted to resolve the numerous problems.

During the course of our audit we visited 33 redemption centers on O‘ahu, Hawai‘i, Maui, and Kaua‘i. We joined the other customers in redeeming containers and experienced the same dissatisfaction with the redemption process as they did. Based on our experiences, some of the redemption centers, especially on Hawai‘i and Maui, are exceptionally well run. Others, mainly on O‘ahu and Kaua‘i, have numerous problems.

### **Redemption center operations are inconsistent**

For a person redeeming containers for the first time, the process can be confusing. One of the reasons is, redemption centers, even those operated by the same entity, have different procedures for accepting containers. Some redemption centers accept containers in the bags in which they are brought by the customer. Others require customers to dump their containers into a basket or trash barrel provided by the center. Some require glass to be sorted by color; others do not. Some limit the quantity to 700 containers per person per day; others say nothing about limits. Some demand that bottle caps be removed from plastic containers. Some redemption centers allow customers to pre-count their containers.

A lack of signs that direct and inform people adds to the confusion. Redemption center employees are usually too busy weighing or bagging containers and paying customers to answer questions or provide assistance. Many people ask others in line about the procedure; one woman told us that the rules keep changing. Since all certification agreements are issued by the same department, the public should have the same expectations regardless of which center they choose to redeem their containers. However, because the Department of Health has not developed standard procedures and levels of service for redemption centers, each center operates in a manner that best serves its needs.

### **Inconvenience poses a major problem**

Part of public frustration is the lack of convenient hours to redeem containers. Redemption centers have certain advertised days and hours during which they claim to be open. On O‘ahu, most redemption centers, other than the mobile centers, are open on weekdays from 9:00 a.m. to 5:00 p.m. and usually for one day on the weekend. Some are closed between noon and 1:00 p.m. for lunch. Thus, during the week, redemption centers are open during the hours when most people are at work and unable to redeem their containers.

Even when redemption centers are supposed to be open, they may be closed. For example, of the complaints logged by the department, 56 involved redemption centers that did not open, and 26 involved redemption centers that either opened late or closed early. There are times when the center’s trailer fills up prior to the end of the day and the

worker closes early. At other times, the center runs out of money and closes. In some instances, the worker simply does not show up, so the center does not open at all. While at a North Shore redemption center, we were told that another center in the area had been partially closed for two days because the trailer was full and a replacement trailer had not been delivered.

Our fieldwork confirmed the problem of centers not opening on time. We arrived at eight redemption centers prior to their advertised opening time either in the morning or after lunch. Of the eight centers, five opened late. We observed customers waiting from 15 to 60 minutes for various centers to open, in addition to waiting their turn in line after the centers opened. Although the department is aware of the problems, few attempts have been made to resolve them.

### **Lack of customer service further frustrates customers**

Several redemption centers we visited on O‘ahu were overcrowded and insufficiently staffed. Many are located in open areas exposed to sun and rain, and waiting in long lines for more than a few minutes can be uncomfortable. A basic level of customer service is lacking.

For example, an O‘ahu redemption center we visited serves a large and densely populated area, but was staffed by only one worker. When we arrived, three people stood in line ahead of us. By the time we redeemed our containers, almost an hour after arriving, 25 people waited in line behind us due in part to a lengthy employee shift change. The two employees, who counted and recounted the cash box funds, were oblivious to the growing line of people.

We spoke with several of the people who expressed their anger with the redemption process, in particular with the time involved, the cost of gas to get to the sites, and the inconsiderate behavior of the attendants. Many of the people said that they were not concerned with recycling but only with getting their money back. We observed a lot of cynicism among those in line and distrust of the State’s motives in adopting the bottle bill program.

### **Neighbor island redemption centers experience fewer problems**

Several of the redemption centers on Kaua‘i had problems similar to those on O‘ahu, mainly because they are operated by the same company whose centers on O‘ahu have the majority of problems. In contrast, the redemption centers we visited on Maui and Hawai‘i appeared to operate more efficiently. Most of the centers on the island of Hawai‘i are located at refuse “transfer stations,” also known as “convenience centers.” They are county operated one-stop centers where refuse is dumped and green waste, cardboard, newspaper, paper, and unlabeled beverage containers

are recycled. In some locations, usable items are donated for re-use. County of Hawai'i recycling specialists say that regular visits by residents to convenience centers for other purposes makes it easier to incorporate redemption into their activities. One specialist reported that residents who go to the convenience centers to redeem containers often begin recycling other products as well. As a result, people are focused on recycling and not just getting their nickel deposits back, unlike O'ahu residents.

In addition, Hawai'i county has partnered with a non-profit organization to provide the redemption operations at the convenience centers. The redemption centers operated by the non-profit that we visited used large canopies or corrugated metal shading to protect the workers and the public from the elements, along with gravel or paved surfaces to provide stability for walking and tables for sorting containers. The centers employed a sufficient number of workers, who were pleasant and helpful. The non-profit routinely writes checks for large redemptions and for cash shortfalls so that it may continue redemptions during posted hours. Most centers close for lunch from 1:00 p.m. to 1:30 p.m., instead of the typical noon to 1:00 p.m., as a convenience for working people who choose to come during lunch breaks. The combination of locating redemption centers at the convenience centers and the county's working arrangement with the non-profit appears to work well for everyone, including the public. We did not experience the problems and confusion that exist at most O'ahu redemption centers.

On Maui, several of the redemption centers are operated jointly by the County of Maui and a recycling company on the island. Four of the centers are located at "county residential drop boxes" where non-deposit containers, cardboard, and newspaper can also be recycled. The redemption process, at those centers we visited, was well-organized, efficient, and consistent at all locations. Customers dumped their containers into clear blue plastic bags provided by the site. This served more than one purpose—it allowed the attendants to visually inspect all containers and prevented customers from being paid for containers that were not HI5 containers. In addition, to avoid running out of money, refunds greater than \$15 were paid by check. We observed the attendants helping customers sort containers, remove caps from plastic containers, and carry bags from cars. Similar to Hawai'i, most of the centers on Maui that close for lunch are closed from 1:00 p.m. to 2:00 p.m. to allow working people to come on their lunch breaks.

### **Confusion about weighing containers heightens frustration**

When the program began operating, the public was unaware that containers could be weighed rather than counted, which caused confusion and distrust of the redemption process. People felt they were

cheated and were not receiving a nickel per container when the containers were weighed. The purpose of weighing is to speed up processing by giving customers approximately five cents per container. Redemption centers have the option of weighing when a person redeems 50 or more containers. The department has also entered into a verbal agreement giving some redemption center operators the option to weigh quantities of 100 or more containers.

The discrepancy in weights occurred because, faced with January 2005 redemption start date and insufficient time, the department adopted California’s per pound rates for containers without testing those rates in Hawai‘i. The California rates turned out to be accurate for aluminum, but not for plastic and glass. After three weeks of consumer complaints, the department conducted its own statewide study of the average number of containers per pound. The result was a revised segregated weight chart as shown in Exhibit 2.1 below, effective March 23, 2005, which more fairly reflects the conversion from weight to number of containers.

**Exhibit 2.1  
Hawai‘i Deposit Beverage Container Law Segregated Rates**

Deposit Container Material Type	01/01/05 – 03/22/05 # of Containers per Pound	03/23/05 until Further Notice # of Containers per Pound
Aluminum	30.0	30.0
Bi-Metal	8.0	8.0
Glass	2.0	2.4
Plastic (PET & HDPE)	12.0	16.6

Source: Department of Health

During our fieldwork, we found that although redemption centers seldom count containers they will accept and pay based on a customer-provided count. If a customer does not have a count, or if the customer requests, the centers will weigh the containers. We found the new segregated rates to be fair for aluminum; if we redeemed 30 cans by weight we were paid \$1.50, the equivalent of five cents per can. However, the refund we received for plastic and glass depended on the size and weight of the containers. Some plastic and glass containers are heavier than others; therefore, it is possible to receive different dollar amounts for the same number of containers.

Many customers we encountered still believe that counting is the only fair way to get their nickels back. One woman regularly drives a great distance from central to leeward O'ahu just to use the reverse vending machines, despite the extra gas and time consumed, because it is the only way she is sure she's getting a nickel per container.

### **Program inspection and enforcement staff members respond reactively to problems**

Program staff members use a reactive, rather than proactive, approach to problems. The Deposit Beverage Container Program currently has three environmental health specialists on O'ahu responsible for the inspection and enforcement of all aspects of the program statewide at redemption centers, retail stores, and distributors. Hawai'i and Maui counties each have two recycling specialists who provide inspection services for the program on their respective islands, and Kaua'i county has one recycling specialist. The neighbor island specialists do not have enforcement authority and must notify the program when enforcement is necessary.

By their own estimates the environmental health specialists should conduct approximately 90 redemption center inspections each month on O'ahu. Instead, inspections have been limited, sporadic, and reactive. The environmental health specialists have averaged only between 15 and 30 inspections per month, mainly because they have been tasked with other responsibilities and are unable to do their jobs. Of the few inspections that have been conducted, most were in response to complaints and addressed specific issues.

Redemption center operations are a major stumbling block in the success of the program. This is due in part to lack of competition among operators of the redemption centers. A single company operates over half of the nonmobile centers on O'ahu. This same company also operates five of the six redemption centers on Kaua'i and one on Maui. Over 90 percent of the complaints received by the department about redemption centers on O'ahu involved the operations of this company. Moreover, the majority of problems we encountered as we redeemed containers on O'ahu and Kaua'i also concerned centers managed by this same operator. Because of all the problems with the redemption centers, it is important for the environmental health specialists to establish a regular physical presence to promote adherence to certification permit conditions, to resolve problems, and to see first-hand the conditions faced by the public.

The specialists have held numerous meetings with the company and issued warning letters in an attempt to resolve recurring problems at various redemption centers operated by this company. However, minutes

of meetings are not recorded, and follow up inspections are not conducted to ensure corrective actions have been taken. Therefore, the problems continue.

In one example of ineffective enforcement, a warning letter was sent to a redemption center operator regarding a windward O‘ahu redemption center. Workers at the center were not paying the refund for deposit beverage containers rejected by reverse vending machines even after the customer clearly showed that the container had the required HI5 label. Prior to sending out the warning letter, two environmental health specialists visited the center and documented, through personal experience and observation, that the center employees were not paying for rejected containers. Nonetheless, after speaking to the employees involved, the operator responded that “... the letter and its (contents) are simply false,” denying that such mistakes had occurred at all. The department did not conduct any follow-up inspection.

The department does have legal authority to invoke fines for noncompliance. Sections 342G-71 and 72, HRS, allow the department to impose fines up to \$10,000 per day per offense or to issue field citations or orders assessing an administrative penalty and ordering compliance or corrective action for violations to the terms and conditions of a certification permit. According to the environmental health specialists, these powers are limited, however, because the department has not developed a fine structure that can be readily imposed.

Enforcement capabilities were also hampered by the department’s own delay in establishing administrative rules. The Legislature incorporated administrative rules for the program into a section of Act 241, SLH 2004, which expired on March 31, 2005. A three-month gap occurred between this expiration date and July 1, 2005, when the new administrative rules became effective. According to the environmental health specialists, the lack of rules during this gap period put the department “in a bad spot,” and the department sent out no warning letters during that time.

The department has acknowledged that it is worse to have a poorly operating redemption center providing “false coverage” for a locality rather than no redemption center. In areas where independent redemption centers have consistently operated poorly and failed to meet certification requirements, the department can revoke their certifications which would close the centers. Instead, the department has allowed the problem redemption centers to continue operating. By failing to take action, the department is allowing the redemption center operators to proceed as they see fit with little regard for the department or the public. Instead of the department managing the redemption center operators, the opposite is occurring.

The department is concerned that if it pursues more aggressive action against poorly managed redemption centers, the program may shut down. However, if the department did revoke the certification permits of such centers, it could put retail stores in a position to become redemption centers. Unless specific conditions are met, any retailer who has more than 5,000 square feet of interior space and is located in a high density population area that does not have a certified redemption center within two miles of it is required by law to operate a redemption center. As long as an independent redemption center continues to operate, no matter how poorly, retailers have no reason to provide redemption services.

***Public education efforts were untimely and static and overlooked the greater environmental message***

Despite a \$728,000 public relations campaign for the Deposit Beverage Container Program, the Department of Health's public education efforts were not effective. Close to three-fourths of a million dollars was spent on hiring a media consultant, production, materials such as posters in retail stores, and media purchases from July 1, 2004 through June 30, 2005. An established program website and several press releases did not lessen the public's confusion about how the program worked and its true intent: to save the environment by diverting waste from the landfills. Information was limited, and it was delivered too late.

**A tardy media plan negatively impacted public education**

Newspaper, radio, and in-store advertising commenced just before consumers began paying the five-cent refund and one-cent handling fee in November 2004 and continued after January 2005 when redemption began. Judging by the hundreds of phone calls the Department of Health received from November 2004, the advertising should have started much sooner. Faced with an overwhelming number of phone calls, the department contracted with Aloha United Way's 211 service to provide basic information starting February 16, 2005. Aloha United Way reported 215 calls for the second half of February, 258 for March, 171 for April, 103 for May, and 70 for June.

When we asked the department why the media campaign started so late, the staff noted that if it started too early the public would have forgotten the purpose of the campaign. We disagree; waiting until a few months before the redemption start date did not give the public enough time to adjust and learn about the program.

**The public received the wrong message**

One main problem with the media campaign stemmed from a public message that focused merely on the monetary benefit, not the larger environmental impact. Specifically, the public education effort focused on the process of redeeming containers for the five-cent refund, rather

than the environmental benefits of the program. According to the recycling coordinator, a disagreement occurred about the message and the target audience. Program staff wanted the marketing campaign to contain more information about the environmental benefits of redeeming cans. For example, after the bottle bill passed in 2002, the Honolulu recycling coordinator, the Department of Health's Solid and Hazardous Waste Branch chief, and the current director of the Office of Environmental Quality Control noted that, at an 80 percent recovery rate projected under the bottle bill, approximately 50,000 tons of beverage containers would be recycled annually in Hawai'i. They further noted that states with deposit laws report 69 to 83 percent decreases in beverage container litter, and with deposit systems creating heightened public awareness, other kinds of litter would likely be reduced.

Despite the staff's rationale, the administration altered the campaign to reflect a mechanical message stating what the public had to do to redeem containers. The department's recycling coordinator believes a difference in public attitude might have been evidenced had the environmental benefits been emphasized. This "procedural" approach resulted in additional problems.

The static message did not respond to consumers' experiences. For example, the department recognized by March 23, 2005 that the containers per pound rates it had adopted for plastic and glass needed revising, but it failed to emphasize why weighing was necessary to speed processing. Additionally, the department did not note that using an average number of containers per pound may not exactly equal the number of containers redeemed. When the containers per pound rates were changed in favor of the consumer after a department study, the department could have done more to explain the change and encourage consumers to use the program.

### **The program needs to earn the public's confidence**

The department needs to continue improving the program by focusing on reliable information and convenient updates for consumers. The department only recently started publishing "redemption rate" statistics instead of "recycling rate" statistics. The bottle bill specifically refers to a redemption rate based on deposit beverage containers redeemed divided by the number of deposit beverage containers sold. Instead of using this formula for the first eight months of the program, the department chose to publicize the *recycling* rate in its press releases and website. The recycling rate is generally a higher percentage than the redemption rate because ineligible containers are included in the calculation. Therefore, the resulting information is irrelevant and misleading in evaluating the program's success. In addition, the redemption rate should be used because of its legal significance.

Section 342G-102(d) calls for the one-cent container fee to increase to 1.5 cents per container when the *redemption* rate increases to 70 percent over the previous fiscal year.

The department needs to provide continuing public education regarding the Deposit Beverage Container Program. For example, the County of Hawai'i runs newspaper ads in the Sunday newspaper showing redemption center locations and hours. On Wednesdays and Fridays small 2- by 4-inch ads are printed, stating basic program facts or answering frequently asked questions such as when containers are counted versus weighed, and how the six cents paid to the retailer is used to refund the consumer and operate the program. The Hawai'i county ads have proven effective based on reader phone call responses immediately after the ads run. Additionally, readers say they regularly look to the ads for updated information.

***A structure does not exist to ensure that funds are properly reported and paid by distributors***

Despite the registration and reporting requirements for deposit beverage distributors in Sections 342G-103 and 105, HRS, the Department of Health has not developed controls to ensure that the information submitted is correct. The department has developed forms that are used by distributors to report containers manufactured and to submit payments to the State. However, the program has not developed procedures to verify that the data submitted on these forms is accurate and that the resulting payments received from distributors is justified. As a result, there is a potential for fraud, which could result in a loss of funds to the State.

**Policies, procedures, and controls have not been established**

The department does not have policies, procedures, and controls in place to confirm that distributors report legitimate numbers in a timely manner. All deposit beverage distributors operating in the State of Hawai'i were required to register with the Department of Health by September 1, 2002. After that date, anyone starting a new deposit beverage distribution business must register with the department at least one month before beginning operations. Between October 1, 2002 and June 30, 2005, 270 distributors have registered with the Department of Health. These distributors have paid over \$39 million into the program's special fund.

Section 342G-105 (b), HRS, requires each deposit beverage distributor to submit a monthly report and payment to the Department of Health no later than the fifteenth day of the month following the end of the payment period of the previous month. The amount paid by the distributor is based on the total number of containers imported or manufactured in Hawai'i less the total number of containers exported for consumption

outside the state. The net number of containers is then multiplied by the sum of the deposit beverage container fee, currently one cent per container, and the refund value of five cents per container.

The department has developed a “Monthly Distributor Report Form” that distributors complete and submit with their payment. They are not required to provide documentation with these monthly forms to substantiate the reported container count even though it is the basis for their payment to the State.

Other than developing a reporting form for distributors, the department has not initiated any policies, procedures, or controls for monitoring distributor payments. No tracking system exists to alert the program when payments are received late, or are not received at all, for a reporting period. Instead, payments are accepted whenever they are received, even months after the due date. In fact, if a distributor’s internal system is set up with reporting dates that differ from those required by statute, the program accepts the alternate dates instead of insisting on distributor compliance with statutory requirements. Consistent policies and timely reporting requirements would enable the department to follow up on delinquent distributor payments and provide relevant data to management.

### **The program cannot validate reported data**

The program has not established a process to validate the data submitted by distributors. Although the program does not demand that distributors submit back-up documentation with their monthly reports, Section 342G-103 (b), HRS, does state that distributors shall maintain records reflecting the containers manufactured, imported, and exported. This requirement, along with the statutory provision that the records of distributors be made available for inspection by the department, an authorized agent of the department, or the auditor, is a critical element to validate the payments received by the department. By imposing these requirements, the law makes distributors aware of their responsibilities, which the department must find a way to enforce.

Program staff have not yet reached the point of being able to audit the records of the distributors and so accept what is reported on the monthly forms. Therefore, during the course of this audit, we selected a sample of distributors for document review. We encountered several obstacles, including distributor delays in providing records and also records that were not available for review because they were stored on the mainland. Sufficient documentation could not be obtained from the selected distributors to support the numbers submitted on their monthly forms, leading us to question the validity of the data.

The main source of revenue for the Deposit Beverage Container Program Deposit Special Fund is distributor payments comprised of the one-cent beverage container fee and the five-cent refundable beverage container deposit. Currently, the payments are based on unsubstantiated numbers. There are no policies, procedures, or controls in place to review and monitor the 270 registered distributors. Although an attempt was made, we could not audit the records of selected distributors. There is no way to confirm whether all required fees are being collected from the distributors and if revenue is being lost. The lack of these components contributes to an environment ripe for abuse.

***Payments to redemption and recycling centers are based on unverified numbers***

From January to June 2005, the first six months of the program, the department paid over \$10 million to redemption centers—approximately \$8 million for reimbursements and \$2 million for handling fees. However, the program has not developed procedures to verify that the data submitted is accurate and that the payments are justifiable. Instead, these payments are made based on unsubstantiated numbers and little, if any, supporting documentation from the redemption centers.

Redemption and recycling centers are paid on the basis of unconfirmed numbers. While distributors provide the majority of revenue for the special fund, payments to redemption and recycling centers make up the major outflow of money from the fund. A total of 15 different entities operate the 57 certified redemption centers in Hawai'i. Ten of the 15 redemption center operators are also recyclers associated with the program. The operations of each redemption center are governed by the provisions of its certification agreement with the department. The agreement incorporates applicable statutes, orders and rules of the department, and contains operating, recordkeeping, and reporting requirements.

Redemption centers are responsible for accepting empty deposit beverage containers, for which a deposit has been paid, and paying the refund value of five cents per container to the people redeeming the containers. In order to obtain a reimbursement for the money it pays out, the center must submit a completed deposit refund request form (DR-1) to the Department of Health. The department does not require redemption centers to provide documentation to substantiate the numbers reported on the DR-1 form.

In addition to a five-cent refund per container, the department also pays redemption centers a handling fee to ensure deposit beverage containers are recycled. Section 342G-117, HRS, states that the handling fee must not be less than the prevailing deposit beverage container fee, currently one cent per container. The handling fee was established by the department on the basis of projected redemption center costs. It was

determined that the handling fee would be two cents per container on O‘ahu and three cents per container on the neighbor islands; the extra cent compensates for additional shipping costs. Redemption centers submit a handling fee request form (HR-1) to obtain payment from the Department of Health. The department does require documentation prior to paying the handling fee, but proof is not always received, and it is difficult to reconcile the numbers provided as documentation to those on the request for payment.

### **Procedures to corroborate quantities and weights do not exist**

The department has not initiated a system to reconcile the quantities and weights submitted by redemption centers for reimbursement payments. Redemption centers are required to provide specific information on the DR-1 form to obtain reimbursements of funds paid out for redeemed containers. In addition to information identifying the redemption center, the form requests the reporting period dates, the outgoing load/container number for recyclables, either the quantity or the weight of the containers, the total refund value, and the name and address of the recycling facility that will be processing the containers.

Although the DR-1 form states that copies of applicable weight receipts, out-of-state transport, and acceptance receipts from permitted recycling facilities be attached, the department does not require them. In fact, the program entered into oral agreements with the redemption centers to omit any documentation as support for the numbers reported on the DR-1 forms. The former accountant for the program told us that when the program started he requested daily records about six times “to keep them honest.” However, because no discrepancies were found between the daily records and the DR-1 forms and because there are not enough program staff, the verification process was discontinued.

During our visit to several redemption centers, we provided an exaggerated count of the number of containers we redeemed. For example, though we had only 40 cans, we said that we had 50. In 15 of 16 cases, we were paid for the count we provided; that is, we were overpaid. During two visits we redeemed containers that did not contain the HI5 label required to obtain a nickel per container, yet we received money for them.

We question how the redemption centers that overpaid us were able to reconcile the container weights or quantities to the money refunded for the day, and what quantities or weights they reported on the DR-1 form. Potentially, the department could be paying the redemption centers for nonexistent and unlabeled containers. According to the former program accountant, the department does not currently verify the weight or

quantity on DR-1 forms to what was paid out by the redemption centers. The department also accepts the numbers submitted by the redemption centers and pays accordingly.

During our interview with the former accountant, we described several scenarios including claiming a higher container count than actually redeemed, redeeming unlabeled containers, and a customer conspiring with a redemption center employee to split money for nonexistent containers. He responded that neither he nor the program employees would know if these events occurred, but they would be considered immaterial considering the high volume of redemptions. Knowing that the possibility for fraud exists, the department should be concerned and take measures to prevent it from occurring.

### **Back-up documentation regarding quantities and weights is insufficient**

The documentation submitted with payment requests for handling fees is inadequate. Although documentation is not required from the distributors when making payments or from redemption centers for reimbursement requests, specific items are required for submission with handling fee requests. When a redemption center, not owned and operated by a recycling facility, submits a handling fee request form (HR-1) it must attach documentation that shows the containers listed on the form have been taken to a certified recycling facility. One hundred percent of the handling fee is then paid to the redemption center.

If the redemption center and recycling facility are the same entity, 50 percent of the requested handling fee is paid upon receipt of the HR-1 and documentation showing that the containers listed on the form were shipped to an end-user, usually a mill on the mainland or in Asia. The remaining 50 percent is paid upon submittal of verification that the containers were received by the end-user. Withholding of the handling fee payment in this manner is current program policy and not a statutory requirement.

While this process sounds straightforward, there are several inherent problems. The documentation submitted with the HR-1 form is supposed to be an indirect way of verifying the numbers on the DR-1 form. The concept is that eventually all redeemed containers must either be taken to a department-permitted recycling facility, transported to an out-of-state end user, or in some cases received by an approved in-state company for an approved end use for recycling. This process appears to work if the redemption center delivers containers to a recycling facility, receives a weight receipt from the recycler, and submits the weight receipt with the HR-1 for a 100 percent handling fee payment.

However, there is often a time lag between when containers are redeemed and when they are shipped to an out-of-state end user by a combined redemption center/recycling facility. The delay occurs because the glass, plastic, or aluminum containers are not shipped until the quantity is large enough to fill a shipping container. This could cause a delay, depending on the size of the facility. It may take another month or more before the shipping container reaches the end user. Furthermore, in order to fill the shipping container, the recycler may combine containers from more than one redemption center and with similar commodities that are not deposit beverage containers, such as scrap metal. The weight on the shipping document is the total of what is in the shipping container. The weight is not broken down into deposit beverage containers and other components. As a result, the weight provided on the shipping documents may not be the same as the weight on the HR-1 and DR-1 forms. When the shipping container reaches the end user, the weight may be different from that on the original shipping document due to shrinkage or contraction from such factors as heat or moisture.

In an attempt to track, verify, and reconcile weights from the DR-1, to the HR-1, to the shipping document, and to the receipt from the end user, the former program accountant developed a spreadsheet. Unfortunately, the spreadsheet was not updated in a timely manner, and even if it had been, it was difficult to reconcile the original reported weights to those on subsequent documents.

Not only does reconciliation of weights present a problem, redemption centers sometimes have difficulty just obtaining receipts from end users. When receipts are acquired, they often don't contain shipping container numbers; therefore, validation by the department is challenging. The department has not attempted to verify the existence of end users and simply trusts that a legitimate company receives the material.

Currently no controls are in place to ensure that redemption centers have been paid only for deposit beverage containers that have been properly redeemed and recycled. While the quantities and weights may appear legitimate on paper, there is no way to tie them together, to validate what is actually being shipped, or to prove that the end users are in fact actual companies in the business of recycling. When policies, procedures, and controls over payments made to redemption centers are lacking, the potential for the improper payment of funds exists.

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## **The Department Has Failed To Establish a Financial Accounting System for the Program**

We contracted with the firm of Shigemura and Sakamaki, CPAs, Inc. (the firm), to audit the financial records and transactions and review the related systems of accounting and internal control for the Deposit Beverage Container Program for FY2004-05. In 2002, the statutes provided for the creation of a government special revenue fund to collect and disburse moneys related to this statewide beverage container program. Special revenue funds are legally restricted to specific expenditures.

During its examination of the program, the firm determined that the Department of Health did not establish a proper accounting system. A proper accounting system acknowledges the importance of internal controls and formal policies and procedures. Together, they ensure that accounting transactions are recorded and reported in accordance with the law and generally accepted accounting principles.

The department failed to set up internal and managerial controls, and it did not have period cut-off or closing policies and procedures for its accounting of transactions. The department was unable to complete reconciliations of accounting records or complete accounting adjustments to prepare the financial statements. Furthermore, the department had difficulty locating documentation supporting its accounting records, thus requiring reconstruction of certain records and substantial adjustments to the accounts. Accordingly, the department could not prepare any financial statements.

Because of the significance of the matters discussed in the preceding paragraph and reported in the following sections, the firm was unable to complete the financial audit. Exhibit 2.2 shows the differences between the department's records for the program and the Department of Accounting and General Services' data. The department was unable to explain the differences, and given the above-discussed conditions, it was impracticable to extend further examination until controls are established and the accounting system is corrected.

### ***The program lacks numerous internal controls***

The firm found that the Department of Health lacks numerous internal or management controls over its Deposit Beverage Container Program. A successful organization needs to have adequate management controls, which would include development of fiscal policies and supervisory reviews. Formal policies need to be developed to provide adequate safeguarding of assets and the proper recording and reporting of accounting information. Additionally, management must further demonstrate its commitment to a strong control environment by enforcing these policies and taking appropriate action when they are not

**Exhibit 2.2**  
**Deposit Beverage Container Program**  
**Deposit Special Fund**  
**6/30/2005**

	6/30/05 BALANCE PER PROGRAM RECORDS	ADJUSTMENTS TO BE MADE	6/30/05 ADJUSTED BALANCE PER PROGRAM RECORDS	6/30/05 BALANCE PER STATE OF HAWAI'I TREASURY REPORTS	DIFFERENCE
CASH	26,535,544	(3,466,628)	23,068,916	23,017,690	51,226
FEE RECEIVABLE (5)	4,819,727		4,819,727	-	4,819,727
			-	-	-
			-	-	-
<b>TOTAL ASSETS</b>	<b>31,355,271</b>	<b>(3,466,628)</b>	<b>27,888,643</b>	<b>23,017,690</b>	<b>4,870,953</b>
<b>TOTAL FUND BALANCE</b>	<b>31,355,271</b>	<b>(3,466,628)</b>	<b>27,888,643</b>	<b>23,017,690</b>	<b>4,870,953</b>
BEVERAGE FEE REVENUE	32,986,069				
INTEREST		313,881 (2)			
UNRECORDED REVENUE		307,597 (3)			
<b>TOTAL REVENUE</b>		<b>621,478</b>	<b>33,607,547</b>	<b>29,442,460</b>	<b>4,165,087</b>
PAYROLL EXPENDITURES	169,449	16,865 (1)	186,314	186,314	-
NON-PAYROLL EXPENDITURES	7,373,880	4,071,241 (1)	11,445,121	11,446,113	(992)
<b>TOTAL EXPENDITURES</b>	<b>7,543,329</b>	<b>4,088,106</b>	<b>11,631,435</b>	<b>11,632,427</b>	<b>(992)</b>
<b>NET CHANGE IN FUND BALANCE</b>	<b>25,442,740</b>	<b>(3,466,628)</b>	<b>21,976,112</b>	<b>17,810,033</b>	<b>4,166,079</b>
FUND BALANCE, BEGINNING	5,912,531		5,912,531	4,956,395	956,136
PRIOR PERIOD ADJUSTMENT	-			251,262 (4)	(251,262)
<b>FUND BALANCE, ENDING</b>	<b>31,355,271</b>	<b>(3,466,628)</b>	<b>27,888,643</b>	<b>23,017,690</b>	<b>4,870,953</b>

Source: Department of Health

**DEPOSIT BEVERAGE CONTAINER PROGRAM**

Notes to the Financial Information  
 June 30, 2005

- Nature of Operations**  
 The Deposit Beverage Container Program (the "Program") was created in October 2002 by Hawai'i Revised Statutes (HRS) Chapter 342G Part VIII, Act 176, 2002 Legislative Session. The Program operates as a unit within the Office of Solid Waste Management of the Hawai'i State Department of Health. The HRS created a government special revenue fund to record receipts and disbursements for the Program.
- Accounting Policy**  
 The Program has deficient internal controls and has not been properly maintaining its accounting records, thus requiring reconstruction of certain records since inception in October 2002, and substantial adjustments

**Exhibit 2.2, continued**

to the accounts. Adequate evidential matter in support of recorded transactions was not available in all cases. Reconciliations, accounting adjustment journal entries and financial statements for the period under audit had not been completed prior to a key employee’s termination. It was impracticable to extend procedures sufficiently to determine the extent to which the financial information as of and for the year ended June 30, 2005, may have been affected by these conditions.

3. Financial Statement Presentation

Due to conditions communicated in Accounting Policy, the financial information is presented to state the differences between the Program’s financial information and that reported in the government’s financial reports as of 6/30/05 and is not in accordance with generally accepted accounting principles.

The Program financial information do not include accounts payable amounts since no adjustment was determined or recorded by the Program prior to the accountant’s termination. Termination of additional testwork on September 1, 2005 precluded completing the search for unrecorded liabilities for 2004-2005.

The following adjustments to the Program financial information are presented to improve comparability with the governmental financial information as of 6/30/05.

- (1) Amount is unrecorded expenditures per 6/30/05 MBPH03 Audit Verification Report recorded in monthly general journal entry.
- (2) Amount is unrecorded interest income per 6/30/05 MBP453-B Source of Receipt Ledger Status.
- (3) Amount is unrecorded beverage distributor fee revenue obtained per 10/14/04 Deposit Summary report from Clerk on 9/1/05. We noted the beverage distributor report source documents are currently still missing.
- (4) Amount is prior year treasury deposit receipt recorded in fiscal year 2003-2004 by Program but incorrectly recorded in Treasury in 2003-2004 to another fund. Adjustment was recorded in general journal entry in fiscal year 2004-2005.
- (5) Fee Receivable is based on the following Program account balances:

Undeposited Funds	4,827,959	(a)
A/R	(365)	(b)
Cash Short/Over	<u>7,867</u>	(b)
	4,819,727	

- (a) Since there is no financial statement cut-off date, undeposited fund amount represents beverage distributor fee revenue related to fiscal year 2004-2005 that was received and recorded thru July 28, 2005 (the date the Quickbooks records for June 30, 2005 was obtained). No additional adjustment was determined or recorded by the Program. The results of subsequent receipt testwork performed through August 16, 2005 resulted in approximately 179,000 unrecorded.
- (b) The A/R amount and Cash Short/Over have been used to record adjustments between reported and received beverage fee remittances for operational purposes. Incomplete reconciliation for 2004-2005 and termination of additional testwork on September 1, 2005 precluded further investigation.

adhered to. The lack of these elements over cash receipts and disbursements and financial reporting has created opportunities for potential abuse and untimely financial reporting.

### **Assets are not adequately safeguarded**

The firm noted through inquiries and observation that the Department of Health inadequately safeguards the assets of the program. For example, deposit beverage distributor payment checks are left in an employee's unsecured mailbox to be processed and recorded. Check remittances left unsecured may be lost prior to processing, and as such, they cannot be detected in reconciliations. The employee processing the incoming mail should prepare a signed control listing of check remittances. The check remittances and a copy of this list should be forwarded to and signed by the employee responsible for processing and recording remittance payments. An independent employee may use the lists to reconcile receipts and research discrepancies. Unprocessed check remittances should be kept secured in a safe or locked desk drawer until processing to prevent potential misappropriation of program assets.

### **Fiscal policies and procedures have not been developed**

The department has not developed fiscal policies and procedures, which resulted in significant deficiencies in the program accounting system and records. When the program began in Fall 2002, a planner with no fiscal background developed operating procedures. Initial program accounting records were maintained on Microsoft Excel spreadsheets. During Fall 2004, a QuickBooks program was utilized to record the increasing amount of receipt and disbursement activity and any prior program information. The lack of formal fiscal policies and procedures resulted in accounting systems being established and operated without regard to internal controls or the program's accounting objectives.

### **Program receipts and disbursements are not properly recorded**

The firm found that the program has been inappropriately recording its program receipts so that it can report on the quantity of deposit beverage containers imported or sold in the reporting month and/or fiscal year. During testwork of receipt transactions, the firm noted that the treasury deposit receipt batches contained deposit beverage distributor remittances for various reporting periods. These transactions were recorded in the program's records by the reporting date instead of the treasury deposit receipt date. The practice of recording receipt transactions based on distributor reporting dates, instead of dates the receipts are received and recorded, prevents the program from identifying instances of non-compliance with payment deadlines. Moreover, there are discrepancies in the dates of when transactions are recorded in the program records versus the state treasury.

During testwork of disbursement transactions, the firm noted that the program has been recording its program disbursements with general journal entries using expenditure information from monthly FAMIS reports instead of when transacted. FAMIS is the Financial Accounting and Management Information System for the State of Hawai‘i. The Department of Accounting and General Services records and reports monthly financial transactions using FAMIS for all state government entities. The practice of recording disbursements using the monthly FAMIS statements results in disbursements not being recorded in a timely manner. Recording disbursements into the accounting system when they are processed assists in the identification of unrecorded disbursements and non-program disbursements recorded in error when the accounting records and FAMIS reports are reconciled.

Furthermore, the firm found that adjustments to recorded transactions are noted in the original transaction entry instead of through general journal entries. For example, the firm found that one large deposit beverage distributor submitted a written request to change its basis for reporting deposit beverage information from imported amounts to sale amounts as provided in Chapter 342G, HRS. This written request documentation was filed within a treasury deposit receipt batch. The request was approved and adjustments to reduce the amounts reported in the respective reporting periods were recorded in the original records of entry. The practice of recording adjustments in original records of entry impairs the identification of adjustments made to previous accounting records and reconciling items. Requiring reviews and documented authorizations by appropriate management provide evidence of managerial oversight when adjustment journal entries are recorded in the financial statements.

### **The program has never closed its books**

The Department of Health does not have any month- or year-end closing procedures for recording accounting transactions and preparing financial statements for the program. The program has not closed its accounting records since its inception in 2002. If a program does not regularly close its books, it cannot ensure proper cut-off—that transactions are recorded in the proper period. Improper transaction cut-off leaves the program with inaccurate financial records. Further, the program does not produce periodic financial statements or account ledgers, leaving no permanent record of fiscal activity. Management is left without the financial reports necessary to evaluate program performance and to detect unusual activity or errors.

The firm printed general ledger detail reports for FY2002-03, FY2003-04, and FY2004-05 from a copy of the accounting records provided on CD as of July 28, 2005 for its audit work papers.

Establishing cut-off and closing procedures ensures that accounting information recorded and reported represents the specific period's fiscal performance. The ability to properly report current period fiscal performance is also vital to management. This information can be used to assess compliance to the program budget and accomplishment of program objectives.

### **Program accounting records are not reconciled**

Although the QuickBooks program is capable of producing various monthly reports, the firm found that these reports are not prepared or reconciled to the FAMIS reports on a monthly basis. The firm also found that certain FAMIS reports needed to reconcile program receipts and disbursements were not provided unless specific requests were made by program staff to the department's Administrative Services Office.

Monthly reconciliations are measures to detect inaccurate financial data. When reconciliations are performed monthly, corrections can be made on a timely basis. Untimely reconciliations make it more difficult to resolve any discrepancies that arise. In some extreme cases, reconciliations may help to uncover fraud schemes. No policies are in place to require monthly reconciliations and corresponding reviews of program reports and FAMIS reports. Consequently, no reconciliations have been prepared.

### **Accounting records have not been reviewed and monitored**

There has been no review or monitoring of program accounting records by staff or the health department's management. The failure to review and monitor accounting records impairs the program's ability to identify, investigate, and report instances of non-compliance and improperly recorded transactions that may affect the operations of the program. Establishing a system to review program accounting records will enable staff and management to monitor adherence to the program's budget and operational objectives.

### ***Financial records are in disarray***

The basic foundation for any financial accounting system is the proper maintenance of accounting records. The department lacks an organized system for the program to maintain its records. This has resulted in incomplete records and records that cannot be easily located.

### **Accounting records are incomplete**

The firm discovered that August 2004 beverage distributor remittances were missing from the program accounting records. Although an Excel spreadsheet was maintained to record the August 2004 remittances, the deposit beverage distributor reports (source reports, which are currently

still missing) were not transferred to QuickBooks when it was set up in Fall 2004. Additionally, there was no reconciliation between the Excel spreadsheets and QuickBooks. The firm determined the August 2004 unrecorded amount to be \$307,597 and recorded an adjustment on the financial information table presented in Exhibit 2.2. In the firm's judgment, this error and omission would not have been addressed and investigated if not uncovered by this financial audit.

The firm also established that copies of the Treasury Deposit Receipts would be forwarded to the program accountant to monitor the timely recording of receipts. During testwork, the firm noted that some copies of the Treasury Deposit Receipts were missing from the program accountant's office. The program accountant maintains a binder of the treasury deposit receipts and was surprised to find that some were missing. Incomplete treasury deposit receipt records impair the program's ability to properly reconcile program receipts. Furthermore, the program was delayed in preparing its reconciliations due to the time it spent waiting for the prior fiscal year records and missing information from the department's Administrative Services Office.

### **Accounting records are not efficiently maintained**

During our testwork of disbursements to certified redemption centers, we noted that the program accountant recorded payments to centers and other vendors using the monthly MBPH03 financial reports using general journal entries. The MBPH03 is a monthly FAMIS report that reports disbursement transactions made under each governmental entity's appropriation number. Appropriations are authorizations granted by the Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Although general journal entries record the information into the QuickBooks records, it does not provide the ability to filter and obtain detailed expenditure information (e.g. vendor name, reporting period) without referring to the MBPH03 or source documents. The ability to obtain detailed expenditure information enables the program and management to review and monitor compliance and the program budget.

Despite the maintenance of adequate cash receipt summary documentation, the current filing of deposit beverage distributor reports by deposit summary batch date created difficulties. The firm noted that there are generally different beverage distributors remitting information for different reporting periods within each of the deposit summary batches. The process of locating selected distributor source reports required looking through all the deposit summary batches. Maintaining periodic deposit beverage distributor reports and relevant correspondence by distributor would enable the program to review reported information and distributor compliance in a timely and efficient manner.

Program staff established their own record keeping system based on their job needs. These records are also maintained within their individual work areas due to convenience. For example, the former program accountant maintained all the certified redemption center deposit and handling fee reports; the program clerk maintains all the beverage distributor registration and remittance reports, Pcard (procurement card) transactions and miscellaneous vendor payments. Additionally, the program coordinator maintains all the contracts and invoices related to the memorandum of agreements with the neighbor island counties; the inspectors maintain the files containing the certifications of the redemption centers and their own work in progress files. The multiple locations for storing program records increases the likelihood of lost and/or unrecorded transactions and limits staff accessibility to the documents.

Source records provide the evidence to substantiate the accounting records and the financial statements. The inability to maintain complete and efficient records creates uncertainty as to the accuracy and reliability of the accounting system and any prepared financial statements.

***Accounting information is not in accordance with governmental GAAP***

Accurate and timely financial reporting is a key factor in management's decision making. Management must have accurate and timely financial information in order to measure the program's performance, identify opportunities for improvement, and strategically plan for the future. However, the firm noted significant deficiencies in the program's financial accounting system that impaired its ability to prepare financial statements that are timely and proper.

Although contracted auditors generally provide assistance with the preparation of financial statements, the department is ultimately responsible for ensuring that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America (GAAP). Those principles are explicated by the Governmental Accounting Standards Board's (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements were issued in June 1999.

The firm noted the program accounting information was set up like an accrual-based corporation, not a governmental entity. An accrual-based corporation is a business entity that uses a method of accounting that records financial transactions for its owner-shareholders to report its profitability. However, governmental units employ a system of budgetary and fund accounting to demonstrate compliance with laws and regulations that govern the expenditure of public resources.

The department's accounting system for the program is not capable of meeting these objectives because it does not use accounts typically associated with a government special revenue fund. For example, budgetary accounts such as "encumbrances" are lacking. Encumbrances are recorded to reserve appropriated amounts for payments against purchase orders and contracts. Although the program executes purchase orders and contracts, this information is not recorded in the accounting system. Instead, program staff monitor purchase order and contract amounts using Excel spreadsheets. Thus, the accounting system does not have the information to report the total amount of encumbrances or unencumbered amounts of the program. This information impacts the remaining fund balance at the end of each fiscal year and would assist management in assessing budgetary compliance.

The firm also noted that the department records deposit beverage container reimbursements and handling fee payments in the "other current miscellaneous" account. This practice prevents the program, management and users of the financial statements from identifying, without additional time and effort, the deposit beverage fees from the handling fees paid to certified redemption centers. Moreover, the program has not accounted for or reported information using the current financial resources measurement focus or modified accrual basis of accounting required of government special revenue funds. The various individuals initially working for the program from 2002 through 2004 were planners and engineers in the Office of Solid Waste Management. They did not have the accounting background or experience to properly perform accounting functions.

Although program accounting staff were hired in Fall 2004, they were not provided sufficient training to correct the accounting system. Interviews with program accounting staff revealed limited understanding of the governmental accounting process, roles and functionality of other governmental departments, and governmental financial reports. The former program accountant admitted he did not fully understand the FAMIS system and reports. Also, he was not aware of how or whether monthly PCard transactions were included in the monthly MBPH03 reports. PCards are the State's defined-use credit cards issued to selected employees. He admitted that the QuickBooks information was missing the PCard information. However, our testwork revealed that the information was recorded since the PCard transactions are included on the monthly MBPH03 reports used to prepare the general journal entries to record expenditures. Furthermore, the acting fiscal officer in the Department of Health's Administrative Services Office admitted he did not understand all the FAMIS reports available and that certain reports are not provided to the various programs unless requested.

The absence of a proper accounting system and poorly trained accounting staff resulted in the program not being able to complete several tasks for the period under audit prior to the former program accountant's resignation. These tasks included the account reconciliations, accounting adjusting journal entries, and financial statements.

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## Conclusion

The public perceives the Deposit Beverage Container Program as an attempt by the State of Hawai'i to impose another tax on them by forcing consumers to pay a refundable five-cent per container fee, yet making it difficult to obtain the refund. Because of the limited number of companies certified to operate the State's redemption and recycling centers, the Department of Health has been hesitant to enforce penalties when the centers fail to operate within the confines of their certification agreements. Consequently the public is forced to deal with numerous problems and inconveniences just to recoup their nickels. The environmental benefits of recycling have been lost in the redemption process. The program can succeed only if the Department of Health commits to providing the support the program desperately needs to operate effectively and proficiently and to properly account for the assets in the program's special fund.

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## Recommendations

1. The governor should assist in the Department of Health's implementation of the Deposit Beverage Container Program according to Chapter 342G, Part VIII, HRS.
2. The Department of Health should:
  - a. fill the Solid Waste Coordinator position;
  - b. reevaluate the program's organization, staffing, and position descriptions;
  - c. provide staff members sufficient time and resources to perform inspection and enforcement responsibilities, including conducting random audits;
  - d. set and enforce standard levels of service for and encourage competition in the operation of redemption and recycling centers;
  - e. establish a graduated fine system to enforce certification permits and standard levels of service;

- f. educate the public on the environmental benefits of recycling, as well as program changes and improvements;
  - g. evaluate whether handling fees paid to redemption centers are sufficient to sustain acceptable levels of service;
  - h. develop and enforce written information technology policies, procedures, and controls, including verification of data reported by distributors and redemption and recycling centers; and
  - i. develop and implement a system that allows for electronic filing of forms and data exchange from distributors and redemption and recycling centers to improve reliability and efficiency.
3. Regarding financial controls, the Department of Health should:
- a. provide fiscal guidance to and/or oversight of the program, including defining the Administrative Service Office's fiscal responsibilities and the applicability of financial accounting reports;
  - b. provide training for staff in the areas of procurement to ensure compliance with Section 103D, HRS, and governmental accounting and the governmental financial reporting process;
  - c. develop, implement, and enforce clearly defined written policies and procedures that ensure consistent and systematic processing of transactions in accordance with the law and governmental accounting principles;
  - d. develop, implement, and enforce clearly defined written policies and procedures for the review and maintenance of program accounting records;
  - e. ensure that proper cut-off dates for transactions and adjustments are developed, implemented, and enforced; and
  - f. ensure that QuickBooks accounting records are periodically reconciled with government financial reports.

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## **Appendix A**

### **Glossary of Terms**

#### **Consumer**

A person who buys a beverage in a deposit beverage container for use or consumption and pays the deposit.

#### **Container Fee**

The one-cent non-refundable fee per deposit container.

#### **Dealer**

A person who engages in the sale of beverages in deposit beverage containers to a consumer for off-premises consumption in the State. Also referred to as “retailer.”

#### **Deposit beverage container**

The individual, separate, sealed glass, polyethylene terephthalate, high density polyethylene, or metal container less than or equal to sixty-four fluid ounces, used for containing, at the time of sale to the consumer, a deposit beverage intended for use or consumption in this State.

#### **Deposit beverage distributor**

A person who is a manufacturer of beverages in deposit beverage containers in this State, or who imports and engages in the sale of filled deposit beverage containers to a dealer or consumer. The term includes federal agencies and military distributors, but does not include airlines and shipping companies that merely transport deposit beverage containers.

#### **DR-1 form**

The deposit refund request form used by redemption centers to claim reimbursement for the five cent refund they pay to consumers.

#### **Handling Fee**

The amount paid to redemption centers for collecting and recycling each deposit beverage container, currently two cents on Oahu and three cents on the neighbor islands.

#### **HI5**

A label or stamp on a deposit beverage container indicating the container is subject to the Hawaii 5-cent refundable deposit and is redeemable.

#### **HR-1 form**

The handling fee request form used by redemption centers to claim the handling fees paid to them for collecting and recycling deposit beverage containers.

#### **Import**

To buy, bring, or accept delivery of deposit beverage containers from an address, supplier, or any entity outside of the State.

**Importer**

Any person who buys, brings, or accepts delivery of deposit beverage containers from outside the State for sale or use within the State.

**On premises consumption**

To consume deposit beverages by a consumer immediately and within the area under control of the establishment, including bars, restaurants, passenger ships, and airplanes.

**Person**

Individual, partnership, firm, association, public or private corporation, federal agency, the State or any of its political subdivisions, trust, estate, or any other legal entity.

**Recycling facility**

All contiguous land and structures and other appurtenances, and improvements on the land used for the collection, separation, recovery, and sale [or] reuse of secondary resources that would otherwise be disposed of as municipal solid waste, and is an integral part of a manufacturing process aimed at producing a marketable product made of postconsumer material.

**Redeemer**

A person, other than a dealer or distributor, who demands the refund value in exchange for the empty deposit beverage container.

**Redemption center**

An operation which accepts from consumers and provides the refund value for empty deposit beverage containers intended to be recycled and ensures that the empty deposit beverage containers are properly recycled.

**Redemption rate**

The percentage of deposit beverage containers redeemed over a reporting period. The percentage is calculated by dividing the number of deposit beverage containers redeemed by the number of deposit beverage containers sold and then multiplying that number by one hundred.

**Refillable beverage container**

Any deposit beverage container which ordinarily would be returned to the manufacturer to be refilled and resold.

**Refund value**

The five-cent refundable deposit, also referred to as “deposit,” or “deposit refund.”

**Reverse vending machine**

A mechanical device, which accepts one or more types of empty deposit beverage containers and issues a redeemable credit slip with a value not less than the container’s refund value. The refund value payments shall be aggregated and then paid if more than one container is redeemed in a single transaction.

**Segregated rates**

The average number of deposit beverage containers per pound of separated aluminum, bi-metal, plastic, and glass containers; used to refund consumers by weight of containers redeemed rather than by individual container count.

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## Responses of the Affected Agencies

### Comments on Agency Responses

We transmitted drafts of this report to the Department of Health on October 28, 2005. A copy of the transmittal letter to the department is included as Attachment 1. The response from the Department of Health is included as Attachment 2. The senior policy advisor for the governor elected to provide a response to our audit and her response is included as Attachment 3.

The Department of Health provided both general and specific comments to the audit, and strongly disagreed with some of the conclusions as being excessively harsh. In its general comments, the Department of Health noted that its redemption rate had increased significantly. However, as noted in our report, we question the validity of the redemption statistics since some of the back-up documentation was missing, and, worse, has not been audited in any manner for accuracy. We also noticed that the redemption rates for months as far back as January 2005, as posted on the department's website, continue to change.

The Department of Health's claim that it can and has accounted for every penny in the program is dubious and shows the department's lack of understanding of the issue. The department claims the program chose to run dual reporting systems; however, FAMIS is not a financial reporting system to begin with. It is incapable of producing financial reports vital to the program, such as balance sheets and income statements. FAMIS primarily reports receipts and disbursements, which are posted by program personnel, and should be reconciled to the program's internal accounting records to ensure the accuracy of both. Additionally, if there are inadequate internal controls over the program's posting of transactions into FAMIS, then placing primary reliance on FAMIS reports would be faulty.

More importantly, the department fails to recognize that the accounting problems extend far beyond the issue of which accounting program serves as the primary reporting system. We reported that the department failed to establish a financial accounting system for the program. The program lacks broad internal controls, and its inadequacies include, among other things, inadequate safeguarding of assets, not establishing fiscal policies and procedures, not reconciling program accounting records, and not performing supervisory reviews of accounting records. We also found that the program does not have an organized system of maintaining accounting records and does not report financial information in accordance with guiding accounting principles. Without a

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comprehensive system of internal controls over the accounting function, the department and program can not provide assurance that all funds are accounted for.

Additionally, the department's claim that certain accounting records could not be located because of employee turnover is false. We are aware that the original treasury deposit receipts are maintained with the Administrative Services Office (ASO). It is for this reason the program accountant maintains copies of these records. However, during our audit, the program accountant was unable to locate certain treasury deposit receipts and indicated that they were missing. This occurred prior to the program accountant leaving the department. The missing documents were eventually located within the ASO; however, it is important for the program to ensure that all accounting records are properly maintained.

Ultimately, the department does not know whether the distributors under-reported containers sold or whether redemption centers over-reported containers redeemed. The department claims to be concerned about fraud, but the system it uses does not insist on redemption center accountability for the basic transaction between consumer and redemption center. We observed and experienced many examples of inaccurate transactions to know that this is a major weakness of the system that is susceptible to exploitation and abuse. Additionally, the departure of the first accountant is irrelevant to the department's inability to produce documents. Requests for documents occurred long before the first accountant's departure. In most instances, the documentation was either non-existent or missing.

The department had also questioned our citing of an 80 percent redemption goal. We note that Section 1 of Act 228, Session Laws of Hawai'i 2005 states that the deposit beverage container program "is still far below its goal of eighty percent redemption." Additionally, information on the department's own Web site repeatedly makes mention of this 80 percent goal.

By its response, the department does not recognize the depth of frustration and anger consumers feel about a process that routinely collects deposits and container fees at the point of sale, but provides a terribly inadequate and inconvenient process to redeem containers for refunds. The department has taken a lax and ineffective approach toward enforcement of redemption center operations.

Whether the administration intended to obstruct the deposit redemption program or not, the administration's positions and actions had that result. The responsibility for a program's implementation rests at the top. Already overburdened department staff members were required to research and support arguments for repeal rather than devoting their time

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to implement the law. We credited departmental staff with working hard to implement the program despite the administration's opposition.

The department also noted that it has drafted procedures that we recommended, is seeking to hire more accounting staff, and will address the specific criticisms in the audit. Finally, the department offered clarifying information, some of which we included in the final report.

The governor's senior policy advisor stated that there were a number of inaccuracies and oversights in our draft; however, we disagree with her opinion. We spent considerable time reviewing documents, conducting interviews, and redeeming containers at redemption centers. Our audit focused on the Deposit Beverage Container Program's compliance with the statute, on the management of the program, and the financial structure of the program. We believe the audit report presents an accurate and balanced analysis of the program as it exists today.

More specific responses to the Department of Health's comments and to the comments of the governor's senior policy advisor are attached.

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**Responses to the Department of Health's general comments:**

1. DOH comment: *Redemptions have increased significantly and the number of certified redemption centers has also increased.*

Auditor's response: **We agree that both redemptions and certified redemption centers have increased since the start of the program in January 2005. However, as stated in our report, redemption centers continue to be plagued with problems. An increase in quantity does not equate to an increase in quality of operations. Apparently many consumers have been willing to put up with inconvenient and unreliable redemption centers to obtain refunds for their containers. If the operations of redemption centers are improved a higher redemption rate should follow.**

2. DOH comment: *We strongly disagree with some of the conclusions as being excessively harsh. The State/DOH has operated the program to succeed, actively and continuously seeks improvements, and sees the program as viable.*

Auditor's response: **We stand by the conclusions in our report. We agree that the program is viable if the administration and the department are willing to provide the resources and support the program needs. Our report points out the major problems that must be resolved in order for the program to succeed. We conducted a very detailed audit and reached conclusions that are credible based on the current operations of the program.**

3. DOH comment: *We point out that some major difficulties, such as the lack of redemptions at retail stores and the limited ability of DOH to force redemption centers to operate on specified days and hours are features of the law and beyond DOH's control.*

Auditor's response: **We disagree that these are major difficulties. The department has the authority to force redemption centers to operate on the days and hours they specified in their application for certification. Currently many of the centers are not doing this which causes problems for consumers attempting to redeem containers. This is a major problem which the department can control if the inspectors are able to get into the field and observe first hand what is occurring at redemption centers as we did during our audit fieldwork.**

**The law also allows for retail stores to operate as redemption centers under certain conditions. However, if the current redemption centers operated in an efficient and consistent manner, there would be less frustration with the process and consumers would not look to retail stores to serve as redemption centers.**

4. DOH comment: *We acknowledge the need for certified redemption centers to improve, have been working with the centers, and will seek further improvements.*

Auditor's response: **We are well aware that the department has been working with the centers; however, the results have been negligible. The program was unable to provide us with written documentation of the meetings and verification to determine whether the centers followed through with the improvements promised.**

- 
5. DOH comment: *We take the possibility of fraud very seriously and are working to prevent it.*

Auditor's response: **While meeting with the Attorney General's Environmental Crimes Unit is an excellent start, there are no policies or procedures in place to prevent fraud from occurring with the redemption centers or the distributors. Many of the prime tasks listed could have been accomplished prior to the start of the program.**

6. DOH comment: *As to accounting, we can and have accounted for every penny in the program, and we will make major improvements in our system. The department has used the mandated, official state accounting system, Fiscal Accounting and Management System (FAMIS), as its primary system. The bottle bill program chose to have a dual reporting system and used a general ledger program as a secondary accounting system for tracking purposes.*

Auditor's response: **The department claims the program chose to run dual reporting systems; however, FAMIS is not a financial reporting system to begin with. It is incapable of producing financial reports vital to the program, such as balance sheets and income statements. FAMIS primarily reports receipts and disbursements, which are posted by program personnel, and should be reconciled to the program's internal accounting records to ensure the accuracy of both. Additionally, if there are inadequate internal controls over the program's posting of transactions into FAMIS, then placing primary reliance on FAMIS reports would be faulty.**

**More importantly, the department fails to recognize that the accounting problems extend far beyond the issue of which accounting program serves as the primary reporting system. We reported that the department failed to establish a financial accounting system for the program. The program lacks broad internal controls, and its inadequacies include, among other things, inadequate safeguarding of assets, not establishing fiscal policies and procedures, not reconciling program accounting records, and not performing supervisory reviews of accounting records. We also found that the program does not have an organized system of maintaining accounting records and does not report financial information in accordance with guiding accounting principles. Without a comprehensive system of internal controls over the accounting function, the department and program cannot provide assurance that all funds are accounted for.**

**Additionally, the department's claim that certain accounting records could not be located because of employee turnover is false. We are aware that the original treasury deposit receipts are maintained with the Administrative Services Office (ASO). It is for this reason the program accountant maintains copies of these records. However, during our audit, the program accountant was unable to locate certain treasury deposit receipts and indicated that they were missing. This occurred prior to the program accountant leaving the department. The missing documents were eventually located within the ASO; however, it is important for the program to ensure that all accounting records are properly maintained.**

**Responses to the Department of Health's attachment containing specific comments:**

p. 1

DOH comment: *The 80% redemption goal is not stated in any legislative act or committee report.*

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Auditor's response: **Section 1, Act 228, SLH 2005, states that the deposit beverage container program "is still far below its goal of eighty percent redemption." In addition, the 80% redemption goal is contained in several informational articles regarding the program.**

p. 3

DOH comment: *Flattening was initially prohibited as an aid against fraud, but allowed in Act 206 (SLH 2005), which DOH supported.*

Auditor's response: **DOH's statement is accurate. Our report does not conflict with that statement as we were summarizing DOH procedures noted on its website.**

p.12

DOH comment: *DOH's budget in 2004 was submitted in time.*

Auditor's response: **We agree DOH's 2004 budget was submitted on time for the 2004 legislative session; our point was that a budget request for the Deposit Beverage Container Program should have been submitted one year earlier in 2003.**

DOH comment: *The Solid waste coordinator position vacancy was not critical because others provided direction.*

Auditor's response: **We disagree that the solid waste management coordinator position was not critical. The existing DOH branch chief, OEQC director and division chief, while supportive of the program and responsible for moving it forward under adverse conditions, were also busy with other priorities. In addition, they were asked to do conflicting work by supporting repeal of the bottle bill. The numerous problems pointed out in our audit are indicative of the lack of a full-time leader and advocate for the program.**

DOH comment: *The audit fails to recognize the law needed major fixes in 2004.*

Auditor's response: **Regardless of what "major fixes" the department or administration perceived were needed for the program, it was still the responsibility of the department to implement Act 176 which became law in 2002. Implementation began too late to be effective. Furthermore, the fixes required were not major. Act 176 indeed contained a defect in Section 342G-Q (Handling fees and refund values for certified redemption centers), with the language "Payment (to redemption centers) of handling fees shall be made not less than six months after the completion of the calendar quarter to which the payment applies." Thus, if a redemption center redeemed a container for a consumer on January 1, and submitted a first quarter report on April 1 for the redemption, it conceivably could not be paid the handling fees until September 1, creating a nine-month delay from the time the container was redeemed.**

**Act 241, SLH 2004, fixed that "nine-month" technical defect by eliminating the offending language, but one year earlier H.B. 1456 (2003) had provided the same relief, only to be vetoed by the governor. In her veto message the governor noted her call for repeal of the bottle bill in 2003 and her intention to seek repeal in 2004 as well. Implementation of Act 176 was not dependent on fixing the "nine-month" defect, but any delay attributed to the defect lies with the governor's veto in 2003.**

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p. 14

DOH comment: *Administration criticism of the program did not stop DOH from implementing the law. Differences of opinion are different from obstruction. Staff should have and did carry on to implement the program.*

Auditor's response: **While we agree that the staff did all they could to implement the program, the administration's criticism of the program and its attempts to repeal the law during the 2003 and 2004 legislative sessions took staff resources away from implementation and sent conflicting signals to the staff.**

DOH comment: *Budget & Finance's reservations do not seem peculiar to this program.*

Auditor's response: **If in fact the Department of Budget and Finance's reservations were not peculiar to this program, then the department head should have argued much more forcefully for a change in attitude with respect to this program. Even a conservative budget and finance should have recognized the urgent need for employees to operate a program with potential revenue of \$48 million per year. How can a special funded program with dedicated funds be expected to start, or attempt to become successful, if even its modest personnel requests are met with circular reasoning to the effect that (1) position approval should not be granted because the positions will be difficult to recruit and fill, and (2) with no prior workload data the six positions may be excessive?**

DOH comment: *The law created "temporary" civil service positions.*

Auditor's response: **The report does not dispute that Act 176, SLH 2002, created temporary civil service positions for the program. The current efforts of the department to have the positions made permanent should help recruitment and retention; however pursuing this course of action sooner may have prevented the accountant from leaving. The program is fortunate to have dedicated employees despite the temporary nature of their positions.**

DOH comment: *The reorganization of the deposit beverage container program took less than three months, not two years as the draft states. It was the reorganization of the Office of Solid Waste Management that took two years to complete, and that occurred before inception of the deposit program.*

Auditor's response: **The information we received from department staff did not differentiate between the two reorganizations as stated in your response. Additionally, since the Deposit Beverage Container Program is part of the Office of Solid Waste Management, it cannot be reorganized on its own. It is our understanding that the reorganization of the Office of Solid Waste Management took place to add the program positions to the office. The bottom line is that hiring of deposit beverage program staff was desired by the branch chief in early 2003, but hiring of program staff did not occur until October 2004.**

p. 15

DOH comment: *The department does pay attention to public complaints, acknowledges the need for redemption centers to operate better, and is hiring a long term marketing and media consultant.*

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Auditor's response: **We stand by the statements made in our report. If the department was paying attention to public complaints and taking action to resolve them, the same complaints would not continue to surface. Most importantly, the department has not advocated vigorously for the consumer and has allowed some poorly run redemption centers to continue operating without effective enforcement of certificate conditions. While the hiring of a long term marketing and media consultant may help inform the public, the underlying problems with the redemption centers must also be resolved.**

p. 19

DOH comment: *Consumers may still receive different dollar amounts for the same number of containers because an average number is being used.*

Auditor's response: **We agree with the department's explanation of, and the reason for, segregated weight rates; however, the department did not adequately explain this to consumers. As a result, consumers continue to have a negative perception of the weighing method.**

**Recommendations:**

1. DOH comment: *The Governor expects the laws to be faithfully executed but reserves the right to seek improvements in the law.*

Auditor's response: **We agree with the department's statement; however, as late as March 23, 2005, the administration stated that it "continues to believe that a comprehensive recycling law would have a more significant impact on solid waste, litter, and recycling, and would be more economical than the present law's limited focus on beverage containers." This statement appears to indicate that the administration does not fully support the Deposit Beverage Container Program.**

2.a. DOH comment: *The solid waste coordinator position was advertised on October 30, 2005.*

Auditor's response: **We commend the department for recognizing the importance of filling the coordinator position and taking action to do so.**

2.b. and c. DOH comment: *The department has evaluated program organization and staffing levels on an ongoing basis.*

Auditor's response: **We look forward to reviewing the results of the department's evaluations during our next audit of the program. As our current audit points out, an adequate number of random inspections has not been conducted because program staff members have been tasked with responsibilities that prevent them from doing so. We continue to emphasize the importance of increased inspection and enforcement activities by the program staff.**

2.d. DOH comment: *The department considered, but did not adopt, standards of operation for redemption centers, and has been advised the statute limits regulation of the centers.*

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Auditor's response: **The department does have the authority to fine or revoke certification of redemption centers that do not comply with their certification agreements. One of the most important standards of operation is the requirement of redemption centers remaining open during the hours stated in their application for certification instead of closing early because they run out of money or storage capacity. This authority is not limited by the statute, only by the department's willingness to exercise it. By not exercising its authority, the department continues to allow redemption centers to foster consumer frustration and distrust in the program.**

DOH comment: *The department believes free market forces will maximize redemption and provide convenience and efficiency.*

Auditor's response: **The department's attempt to strike a balance between government regulation and free market forces in its regulation of certified redemption center operations has not been successful. Free market forces, in their worst manifestations as poorly operated redemption centers, have allowed the centers to maximize their income and limit their costs by providing insufficient container storage facilities, insufficient refund cash, and insufficient staffing. Consumers faced with a department store that is not always open during its advertised hours of operation have several other stores to choose from. Unfortunately, consumers attempting to redeem deposit beverage containers often do not have many options, at least without driving for great distances. When redemption centers are closed during their advertised hours, the consumers pay heavily with their time. Providing 100 percent reliability and convenience for consumers does not appear to be a goal for certain redemption center operators, nor for the department. Thus, the department has not struck that balance between regulation and free market forces, because it has not regulated in any meaningful way and has allowed undisciplined free market operators to function without consequence.**

DOH comment: *The department does not discourage competition in redemption centers.*

Auditor's response: **We agree that the department does not discourage competition with regard to redemption centers; however, it should actively encourage competition and prevent anti-competitive practices that some redemption center operators or recyclers may attempt to engage in.**

DOH comment: *The department continues to examine minimum operation standards and enforcing certifications more formally.*

Auditor's response: **Until the department adopts minimum operation standards and enforces certifications more formally the public will continue to suffer the consequences of poorly managed redemption centers.**

2.e. DOH comment: *The department has powers under the statute to implement "field citations" for smaller scale infractions but needs to amend its rules to implement such a system.*

Auditor's response: **We disagree with this statement. Section 11-282-04(b)(1) of the administrative rules currently allows the director to issue a field citation assessing an administrative penalty and ordering corrective action immediately or within a specified time. The department's approach of addressing issues directly with the certified redemption center operators is not working because the problems continue to exist. Consumers still do not have the reliability and convenience they demand and deserve.**

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2.f. DOH comment: *A contractor will be chosen to provide marketing, including surveys and focus groups to improve public participation.*

Auditor's comment: **Although the department should have been concerned with improving public participation prior to starting the program, the primary means of doing this is to provide convenient, efficient, and reliable redemption opportunities.**

2.g. DOH comment: *The department will discuss and evaluate sufficiency of handling fees, monitor trends, and consult with California.*

Auditor's response: **We believe that initiating these actions is a good start in evaluating the handling fee. We are concerned about the lack of formality and lack of articulation of factors that accompanied the decision to set handling fees at two cents for Oahu and three cents for the neighbor islands. In many instances the amounts may be too high, and in certain remote locations, the amounts may be too low. For example, the market prices for recycled aluminum, plastic, and glass are clearly important factors in calculating whether the redemption centers are profitable or not, but these factors were not considered in setting the rates. Aluminum, for example, was recently compensated at 62 cents per pound. The department's current average is 30 containers per pound of aluminum, which means redemption center operators receive nearly two cents per container from an aluminum recycling mill in addition to the two or three cent handling fees paid from the program's special fund. Handling fee rates are an expense over which a significant amount of departmental discretion is exercised, and, over time, will affect whether the program is run efficiently or not. The department should pay more attention to this item.**

2.h. DOH comment: *Staff is developing information technology policies, procedures, and controls for the program.*

Auditor's response: **While we commend the department for its actions, these policies, procedures, and controls should have been in place when the program began operations. We look forward to reviewing formal, documented department and program IT policies and procedures and program internal controls during our next audit.**

2.i. DOH comment: *Electronic filing of forms may not expedite processing because checks and hard copies of shipping reports and end user documents are required.*

Auditor's comment: **Electronic filing may be easier for the distributors and redemption centers, and could save time now used to check the math on the hard copies. This would allow more time to be spent on verifications and reconciliations. Currently all submissions must be re-keyed by program staff which can lead to the introduction of more errors. Payments and back-up documentation can be mailed to the department.**

3.a. DOH comment: *The Department began a comprehensive review of the program's accounting policies and procedures, and expects to complete development of such written policies and procedures by the end of December 2005.*

Auditor's response: **While these actions are commendable, the policies and procedures should have been in place prior to the start of the program. Lack of policies and procedures resulted in the CPA firm's inability to complete the financial audit of the program.**

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3.b. DOH comment: *The department will review staff procurement training and conduct training as necessary.*

Auditor's response: **We again state the importance of initial and continual staff training in these areas.**

3.c., d., e., and f. DOH comment: *Please refer to the department's response to 3.a.*

Auditor's response: **Our response to 3.a. is also applicable to these sections.**

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**Responses to the letter from Linda L. Smith, Senior Policy Advisor for the Governor:**

The Governor's Senior Policy Advisor provided comments to the audit, and stated there were inaccuracies and oversights in the draft. We stand by the information and conclusions in the report. Information included in the report was obtained from Department of Health documents and staff, and interviews with department and administration officials.

The senior policy advisor claims the department had only four months to prepare for the new deposit beverage container program. This is not accurate. Under Act 176, SLH 2002, the department began collecting half-cent fees on deposit beverage containers from distributors in October 2002. Act 176 also required consumer container redemptions to commence on January 1, 2005, more than two years later. Yet the department did not hire the first of six staff members for the program until October 2004. The sixth program staff member was hired in June 2005.

The senior policy advisor further claims that Act 241 amended Act 176 on July 13, 2004, and left only four months to start collecting container deposits on November 1, 2004. This is misleading. First, H.B. 1456 (2003) made similar changes to Act 176 in the 2003 Legislature, but these changes could not be implemented because H.B. 1456 was vetoed by the governor. Second, the need to label deposit beverage containers and begin consumer redemptions by January 1, 2005 had always been part of the original Act 176. Had the department been working diligently on program planning and preparation from early 2003, it should have been able to accommodate the November 1, 2004 adjustment in stride.

The senior policy advisor states the report overlooks the numerous meetings and working group meetings convened by the department from mid-2004 on. Faced with last-minute implementation of the program, the department worked hard to catch up, and the report recognized the contributions of existing department staff for starting to develop the program in addition to doing their regular jobs. However, the time, energy, and focus the existing staff had to give were insufficient for the nature of the tasks before them.

The senior policy advisor notes the complexity and size of the beverage manufacturing, distribution, and retail systems that had to be addressed prior to start up. It is precisely because of the complexity of coordinating distributors, retailers, redemption operators, and consumers to implement a new, \$48 million per year program that the report criticizes the department for not starting much sooner with additional staff members dedicated specifically to the new program.

The senior policy advisor asserts that the department prepared administrative rules based on the original statute (Act 176) and therefore had to do such things as rule-preparation twice because of Act 241 in 2004. We agree that the department was required to do rule preparation twice, but rule changes almost always accompany statutory changes and are part of the work of government. The department convened an advisory committee in September 2002 to develop administrative rules. The committee's work was completed by August 2003. Because H.B. 1456 had been vetoed in June 2003, the Legislature enacted changes in Act 241, SLH 2004, and incorporated consistent administrative rules in the statute. The administrative rules were designed to lapse on March 31, 2005, approximately nine months later. The department failed to renew the program's administrative rules on time, causing a three-month gap from April 1 through June 30, 2005, during which time the program had no effective rules.

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Regarding education and outreach, the senior policy advisor notes that extensive work went into developing appropriate community outreach, and claims that Act 176 set up a confusing redemption system with eight different entities. The redemption system is similar to the system in use in California since 1986. Exhibit 1.4 in the report illustrates the redemption system. Of the eight entities involved, six have always been there (distributors, retailers, consumers, recycling companies, shippers, and recycling material end-user mills). The two new entities are the department, which collects the deposits and container fees, and the redemption centers, which refund the deposits and collect the containers. The law is based on experience that voluntary recycling alone results in a container recycling rate of approximately 20 percent, and that deposit incentives achieve redemption rates of approximately 70 - 90 percent.

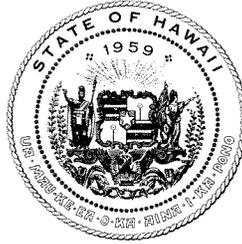
The senior policy advisor suggests that we intended for the department to tout recycling in the abstract without detailing redemption methods. Based on department staff interviews, we found that program staff members who advocated a more substantial environmental message were overruled by the administration in favor of a message that concentrated on the nuts and bolts of redemption. Based on consumer reactions in the field and logged complaints, we concluded that the department's education and outreach started too late and the message did not prepare the public to support recycling for its environmental benefits in addition to its redemption values.

The senior policy advisor claims there are basic problems with the law because it is complex, convoluted, and difficult to administer. We did not focus on comparison of various redemption systems for this first audit, but we disagree. We focused on the law as it was written and the department's performance in implementing it. The law is based on conveniently located and reliably operated independent redemption centers, pioneered in California in 1986. Older systems in other states involve retailers and distributors redeeming containers they sell. Both systems achieve approximately 70 - 90 percent redemption rates.

Although the senior policy advisor's comments suggest that the administration will now support amending the law to require all retailers to redeem containers, the department should be able to resolve current redemption problem areas under existing Hawaii law. Where independent redemption centers are not convenient and reliable, the department could revoke their certifications and require large retailers to provide redemption services instead. This approach would preserve the efficiencies of the convenient and reliable independent redemption centers that are working well in certain parts of the state, and would involve retailers where redemption centers are failing. This requires systematic enforcement and consumer advocacy which the department needs to work on.

**ATTACHMENT 1**

STATE OF HAWAII  
**OFFICE OF THE AUDITOR**  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



**MARION M. HIGA**  
State Auditor  
  
(808) 587-0800  
FAX: (808) 587-0830

October 28, 2005

***COPY***

The Honorable Chiyome L. Fukino  
Director of Health  
Department of Health  
Kinau Hale  
1250 Punchbowl Street  
Honolulu, Hawai'i 96813

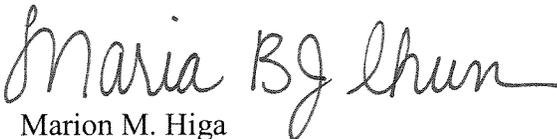
Dear Dr. Fukino:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Audit of the Deposit Beverage Container Program*. We ask that you telephone us by Tuesday, November 1, 2005, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, November 7, 2005.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

  
for Marion M. Higa  
State Auditor

Enclosures

LINDA LINGLE  
GOVERNOR OF HAWAII



CHIYOME L. FUKINO, M.D.  
DIRECTOR OF HEALTH

STATE OF HAWAII  
DEPARTMENT OF HEALTH  
P. O. BOX 3378  
HONOLULU, HI 96801-3378

In reply, please refer to:  
File:

November 10, 2005

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OFC. OF THE AUDITOR  
STATE OF HAWAII

Ms. Marion M. Higa  
State Auditor  
Office of the Auditor  
465 South King Street, Room 500  
Honolulu, HI 96813-2917

Dear Ms. Higa:

Re: Audit of the Deposit Beverage Container Program  
Draft of October 28, 2005

Thank you for providing us a copy of the draft audit report for review and comment. We provide general comments and attach comments on selected specific points and respond to the draft recommendations. We ask that our comments be used to make changes in or be attached to the final report.

#### General comments

1. We stress that **redemptions have increased significantly**. The redemption rate in January 2005 when redemptions started was about 20%, and in July-September 2005, the rate averaged 81%. Our overall redemption rate for October 2004 through September 2005 is about 54%. The number of certified redemption centers increased from 46 at the start of redemptions in January 2005, to 74 today (56 + 18 mobile sites).  
  
By comparison, California averaged 55% redemption in its first year of implementation (1988). Our program now has a comparable rate.
2. We strongly disagree with some of the conclusions as being excessively harsh. The State/DOH has operated the program to succeed, actively and continuously seeks improvements, and sees the program as viable.
3. We point out that **some major difficulties**, such as the lack of redemptions at retail stores and the limited ability of DOH to force redemption centers to operate on specified days and hours **are features of the law and beyond DOH's control**.
4. We acknowledge the need for certified redemption centers to improve, have been working with the centers, and will seek further improvements.

5. We take the possibility of fraud very seriously and are working to prevent it.

We acknowledge the important need for verification of claims of containers redeemed, recycled, and for payment, and we turned our attention to these matters even before the audit started. We met with the Attorney General's Environmental Crimes Unit about that subject before the audit started, to gain advice on how to deal with the threat and to set up working relationships and procedures with the Attorney General's criminal enforcement staff. However, in the first months of the program, our prime tasks were to get the redemption centers certified, educate the public, work with the counties, and pay the certified redemption centers to help them start up.

6. As to accounting, we can and have accounted for every penny in the program, and we will make major improvements in our system.

**The Department has used the mandated, official state accounting system, Fiscal Accounting and Management System (FAMIS), as its primary system.** The bottle bill program chose to have a dual reporting system and used a general ledger program as a secondary accounting system for tracking purposes. Due to the vacancy of the Accountant III position, some entries to the secondary system were not maintained, but all entries were recorded to the primary system (FAMIS).

The program understands the importance of maintaining adequate records and has since updated all entries to the general ledger program and has reconciled the balances to FAMIS for both FY 05, and for FY 06 for July- September 2005. As with other programs, all documentation of the receipts (Treasury Deposit receipts) and disbursements (Summary warrant vouchers) are filed in the accounting department at the Administrative services office and not at the program's location. Thus **the department had the documents the contract accountants sought, but the program had difficulty producing them because the first accountant had left for a permanent position at another agency while the audit was being conducted.**

The program is currently in the process of creating standard operating procedures. We have drafted procedures that you recommended, are seeking to hire more accounting staff, and we will address the specific criticisms in the audit.

Thank you for the opportunity to comment on the draft audit report.

Sincerely,

  
Chiyome Leinaala Fukino, M.D.  
Director of Health

## ATTACHMENT

Specific Comments. We comment on the following selected specific items in the audit.

p. 1

The 80% redemption goal is not stated in any legislative act or committee report.

p. 3

Flattening. The law initially prohibited flattening as an aid against fraud. However, the legislature later allowed flattening in Act 206, which DOH supported. In general, the audit should distinguish between statutory and other requirements (e.g. rules, permits).

p. 12

The DOH budget in 2004 was submitted in time. DOH could have and should have submitted its request for positions earlier.

The vacancy in the solid waste coordinator position was not critical. The branch chief, then the OEQC director and division chief provided direction.

The audit fails to recognize that the law still needed major fixes in 2004. For example, until amended in 2004 the law would have made redemption centers wait 9 months for reimbursement of deposits and receipt of handling fees, and it is unlikely they could have afforded to advance so much money so long.

p. 14

Administration support for comprehensive recycling led by the counties and accompanying criticism of the DBC law never stopped nor was it intended to stop DOH from trying to faithfully execute the law, and we took the administration's policy position as separate from the nuts and bolts of implementation. Given the magnitude and newness of the program, it was inevitable that there would be differences of opinions on matters, but those are different from obstruction. From my standpoint, staff should have and did carry on professionally to implement the program to the best of their abilities, whatever the uncertainties they may have felt about the fate of the law.

The reservations expressed by the Department of Budget and Finance do not seem peculiar to this program but reflect a strong conservatism that B&F displays in all fiscal matters.

We note that the law itself created "temporary" civil service positions, and that status already makes recruitment more difficult. We already lost our first accountant because he took a full time position in another department. We are seeking to have the positions made permanent.

The reorganization to establish the Deposit Beverage Container Program took less than three months, not two years as the draft states. It was the reorganization of the Office

of Solid Waste Management that took two years to complete, and that occurred before inception of the deposit program.

p. 15

The department does pay attention to public complaints. We acknowledge that redemption centers need to operate better and that we need to inform the public on the days and hours of operation. We anticipate that the hiring of a full time, long term marketing and media consultant will help the program considerably in getting the word out. The contract should be finalized soon.

p. 19

We acknowledge that it is still possible with the segregated (weight) rates to receive different dollar amounts for same number of containers, but this is an inherent feature of using an average. The rates were adopted to provide a convenience to consumers and help the recyclers process containers faster.

Recommendations. We respond (*in italics*) to the draft audit's recommendations:

1. The Governor should assist in the Department of Health's implementation of the Deposit Beverage Container Program according to Chapter 342G, Park VIII, HRS.

*The Governor expects the laws to be faithfully executed but reserves the right to seek improvements in the law.*

2. The Department of Health should:

- a. fill the Solid Waste Coordinator position;

*The solid waste coordinator position was advertised on October 30, 2005.*

- b. re-evaluate the program's organization, staffing, and position descriptions;
- c. provide staff members sufficient time and resources to perform inspection and enforcement responsibilities, including conducting random audits;

*b & c. Since full program start-up on January 1, 2005, the department has evaluated program organization and staffing levels on an ongoing basis.*

- d. set and enforce standard levels of service for and encourage competition in the operation of redemption and recycling centers;

*The department did examine adopting certain standards of operation for certified redemption centers (CRCs) before the start of redemption services. The situation, however, is more complicated than it initially appears because of the multitude of factors that affect certified redemption center operators.*

*The department chose not to adopt any standards in its initial administrative rules. We have been advised that the statute limits departmental regulation of the centers.*

*Additionally, the department sought to strike a balance between government regulation and free market forces in its regulation of CRC operations. The primary rationale being that, as businesses, certified redemption centers would choose to maximize redemption by means available to any free enterprise. Some examples being: obtaining convenient locations for their redemption centers, providing convenient operating hours, and providing efficient and professional service.*

*The department does not discourage competition in the establishment and operation of CRCs. The fact that the majority of redemption center sites on Oahu are operated by a single business entity is a product of the free market and is beyond control of the department. And, as explained above, the department made clear decisions in its regulatory approach that were based on a clear deference to market forces.*

*The department is acutely aware of operational deficiencies the public has encountered at various redemption centers. We have, and will continue to, address these issues directly with CRC operators.*

*The department also continues to examine the possibility of implementing minimum operating standards of operations for CRCs and of enforcing existing certifications and permits more formally.*

- e. establish a graduated fine system to enforce certification permits and standard levels of service;

*The department currently has clear enforcement powers under statute and administrative rules.*

*The department had considered implementing a system of "field citations" that would be issued in the field by deposit program inspectors. Field citations would cover smaller scale infractions by CRCs and are advantageous in that they do not entail a lengthy administrative process such as Notices of Violation.*

*The department will continue to study the possibility of implementing field citations into its enforcement efforts. The department will have to amend its rules to implement such a system.*

- f. educate the public on the environmental benefits of recycling, as well as program changes and improvements;

*The Deposit Beverage Container Program completed a Request for Proposal in October 2005 to secure long-term marketing services. The*

*contractor's Scope of Services includes conducting a survey & focus group to identify the best way to improve the public participation. Using this information we will be able to provide marketing & outreach that effectively increase Deposit Beverage Container recycling.*

- g. evaluate whether handling fees paid to redemption centers are sufficient to sustain acceptable levels of service;

*The department will continue to discuss the handling fees CRC operators and will evaluate if the fees are sufficient in offsetting costs of processing and shipping material to the end market. Department staff will continue to monitor trends in markets to determine if fee adjustments are necessary. Additionally, staff will communicate with the California Department of Conservation about their deposit program's handling fees and determine if any adjustments made in California's program would be applicable for Hawaii's program.*

- h. develop and enforce written information technology policies, procedures, and controls, including verification of data reported by distributors and redemption and recycling centers; and

*Staff is developing policies, procedures, and controls for the program.*

- i. develop and implement a system that allows for electronic filing of forms and data exchange from distributors and redemption and recycling centers to improve reliability and efficiency.

*The department has considered electronic filing in the past and will continue to investigate its use. However, switching to electronic filing of forms may not expedite the processing of forms. Distributors are required to submit checks with their forms and redemption centers are required to provide hard copies of shipping reports and end user documents. Forms are processed for deposit or payment only when the department receives the require checks and/or back-up documentation.*

3. Regarding financial controls, the Department of Health should:

- a. provide fiscal guidance to and/or oversight of the program, including defining the Administrative Service Office's fiscal responsibilities and the applicability of financial accounting reports;

*During the audit proceedings, the department began a comprehensive review deposit program's accounting policies and procedures. As a result of this review, the department is in the developing written policies and procedures that address several areas of the deposit program's accounting. Several of these policies currently exist in draft form and await review and final adoption. The department expects to complete*

*implementation of all accounting policies and procedures by the end of December 2005.*

*Specific areas that are addressed by the draft policies and procedures include: distributor payment deposits, Quickbook procedures, reconciliation of financial records including Quickbooks and FAMIS, clear definition of ASO responsibilities, and revision of certified redemption center payment requests procedures and forms.*

- b. provide training for staff in the areas of procurement to ensure compliance with Section 103D, HRS, and governmental accounting and the governmental financial reporting process;

*The department will review staff training needs with regards to procurement, and will conduct training as necessary.*

- c. develop, implement, and enforce clearly defined written policies and procedures that ensure consistent and systematic processing of transactions in accordance with the law and governmental accounting principles;
- d. develop, implement, and enforce clearly defined written policies and procedures for the review and maintenance of program accounting records;
- e. ensure that proper cut-off dates for transactions and adjustments are developed, implemented, and enforce; and
- f. ensure that QuickBooks accounting records are periodically reconciled with government financial reports.

*For items 3.c – 3.f, please refer to the department’s response to recommendation 3.a*



EXECUTIVE CHAMBERS  
HONOLULU

LINDA LINGLE  
GOVERNOR

November 10, 2005

RECEIVED

Ms. Marion Higa, State Auditor  
Office of the Auditor  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813

2005 NOV 14 PM 1:14

OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

We appreciate the opportunity to comment on the Draft Audit of the Deposit Beverage Container Program. There are a number of inaccuracies and oversights in the draft and we hope you will use this response to modify the final document prior to its issuance.

First, we would like to point out that the Department of Health had four months to prepare for the new beverage container deposit program, not two years as stated in the draft audit. The Legislature realized there were significant problems in Act 176 after they passed this law in 2002. As a result, the Legislature worked an additional two years to change the statute and finally passed Act 241 which became law on July 13, 2004.

Among other program changes, the 2004 law accelerated the time in which the Department had to start collecting monies under the beverage container deposit program from the original date of January 1, 2005 to November 1, 2004. This further lessened the period of time the Department had to implement the program.

The draft report makes scant reference to the numerous meetings and working group efforts convened by the Department of Health to implement the law as it was finally enacted in mid-2004. Neither does the report discuss the complexity and size of the beverage manufacturing, distribution, and retail systems that had to be addressed prior to the start up of the program. We would ask that your audit staff spend additional time talking to the Department of Health and documenting the efforts they undertook between July and November to move into the operational phase of the program.

Additionally, we would ask that you incorporate the work the Department did prior to July 2004 in anticipation of the law's enactment, including the preparation of administrative rules that were based on the old statute. In particular, you may want to reference and excerpt from the Department of Health's report to the Twenty-Second Legislature. It helps explain that the Department had to do some the preparations twice

Ms. Marion Higa  
November 10, 2005  
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since the program was being modified by the Legislature and we were working, in effect, with a moving target.

Second, the draft audit does not appreciate the extensive work that went into the development of appropriate outreach to the community as the program was launched. Our research found that the law set up a redemption system that was confusing to the general public and involved eight different entities just to remove one beverage container from the waste stream. In light of this, it was critical that the initial messages help people specifically understand how they could recycle their cans and bottles, in addition to the environmental message about the benefits of recycling. In fact, each message ended with the importance of recycling for the sake of the aina. However, touting recycling in the absence of how you performed it under the new law would have been a recipe for failure. The Department worked hard to ensure the public outreach campaign was in line with the questions we were receiving about the program. We would ask that you revise this portion of your draft report to recognize the importance of both messages.

Third, the draft audit does not address the basic problems with the law. The Hawaii statute set up a beverage container redemption system that is complex, convoluted, and difficult to administer. It is unlike systems that have worked in the other jurisdictions that maintain beverage container redemption programs. The failure to enact a statute that has retail stores serving as both the sellers and redemption centers for the cans and bottles led to many of the challenges faced with operating the program in Hawaii

If the traditional recycling models had been enacted, the entire section of your draft audit on the operations of the redemption enters would be moot, as would the sections regarding the State accounting procedures, since stores would be collecting and returning deposits to consumers. It would be helpful if the audit had a broader scope and discussed what works in other jurisdictions and how their programs could be a superior operational model to the one currently in Hawaii law. Doing this could move the dialogue forward in a positive fashion.

We hope these constructive comments will help you and your staff to revisit the approach and content of the draft. My office and the Department of Health stand ready to assist you in modifying the report so that we can provide the Legislature with advice on what they can do to improve the beverage container deposit program.

Sincerely,



LINDA L. SMITH  
Senior Policy Advisor